GOVERNMENT

AND

BUSINESS

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BY

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To

Jennie Howard Hall

PREFACE

One of the important developments of the past few years in the United States has been the increase in the control of business by both Federal and state governments. The legal, economic, and political implications of this are tremendous. The fate of many of our present institutions may well rest upon our ability to solve successfully the problems of governmental control.

Although there has been an increasing interest in and an awareness of the importance of this development, the subject of government and business has not been given the place in the curricula of the colleges and universities which its importance would seem to deserve. Many courses, such as economics, Federal and state government, public utilities, transportation, and insurance, treat the question of government control as it pertains to the particular field in question. Such partial treatments, however, seem inadequate in view of the tremendous importance of the subject. This text has been written in order to give the student a comprehensive picture of the field of government control of business and to offer him an opportunity to compare and contrast the control exercised over one industry with that exercised over another. It is hoped also that this book may stimulate a more general interest in the subject of government and business than has existed in the past, not only among college students but also among other persons and groups.

The first edition was published in an abbreviated form. Such brief treatment obviously had its limitations. It is sincerely hoped that the more extensive treatment here attempted will be more adequate for the needs of those who are interested in the subject.

I wish to acknowledge again my indebtedness to all those persons who so kindly and ably assisted in the preparation of the

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FORD P. HALL.

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CONTENTS

GOVERNMENT AND BUSINESS

CHAPTER I

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Political theory has been conditioned largely by environment. Speculations upon the state and its functions have reflected the social, economic, and political problems with which individuals and groups have been confronted. During the Middle Ages, preparation of man for a future life was considered to be a matter of great moment. This was reflected in the writings of Thomas Aquinas, one of the great political philosophers of that period. During early modern times, the insecurity of individuals and states and the struggles for power colored the political writings of such men as Bodin, Hobbes, and Locke. To them the question of sovereignty, where it resided and by whom it should be exercised, was of much importance. With the growth of industrialism and the development of the factory system, it was but natural that speculation upon the relation of the state to the economic system and institutions should occupy a prominent place in political philosophy. The emphasis upon this has continued to increase. As men have become less concerned about theological controversies and have worried less about possible depredations on the part of their neighbors, the question of their material welfare has given them more and more concern. The economic crisis through which the world has recently been passing has tended to turn men's thoughts more than ever in this direction.

As a result of this crisis, a flood of criticism has poured out upon the economic and political institutions of Western civilization. To many thinkers and writers it appears that there are fundamental defects and weaknesses; that important innovations will have to be made; and that, even though one such crisis is weathered with existing machinery and institutions, others are

likely to follow, one after another, until the whole patchwork mechanism collapses through sheer incompetence. According to such critics, one of the greatest weaknesses of society has been its utter "planlessness." Violent fluctuations in prices, overproduction, needless duplication, extravagance, and poverty are cogent evidences of the need for some kind of planning. Schemes for social and economic planning have been advanced by the score. In these the functions of the state vary greatly. The most radical would subject the lives of all persons to minute supervision and guidance by the state. Others advocate price control or limitation of production, or a more equitable distribution of wealth. Some of the schemes go little farther than to suggest a repeal of the antitrust laws so that business may fix prices without fear of prosecution. For the most part, all of these plans are but variations or manifestations of fundamental political theories or philosophies of the functions of the state.

It is difficult to make a classification of the theories of the functions of the state which will not break down under a searching analysis. For one thing, each shades so imperceptibly into another that it is almost impossible to draw a sharp line of demarcation. Furthermore, there are many subdivisions and some of these show much variation. Finally, what one author considers a main subdivision is considered by another a minor point.

Broadly speaking, theories concerning the functions of the state may be grouped under five large headings: anarchism, individualism, collectivism, socialism, and communism. Anarchism, representing the one extreme, advocates the total abolition of the state. Communism, at the other extreme, places the ownership of all property in the hands of the state and subjects the lives of individuals to extensive control and supervision. Between these two extremes lie individualism, collectivism, and socialism. Each of these three theories will be given more detailed consideration.

The part which political theory plays in shaping policies or determining the functions of government should not be overemphasized. Often a situation arises, a practical solution is found, and then some new theory is developed or some extant theory is seized and applied in order to justify the practice. Furthermore, most persons who are active in commerce, law, or

politics are not consistent believers in any one political philosophy. They usually advocate individualism until it suits their purpose to have governmental interference. With individualistic dogmas and arguments, commercial and industrial leaders violently oppose government regulation of business, and immediately turn about and with paternalistic arguments heartily support governmental interference through the medium of a high tariff. The owners of restaurants or the proprietors of grocery stores often eagerly support a stringent regulation of electric, gas, and water utilities but wholeheartedly oppose any kind of legislation which will subject them to state control.

I. Individualism.

Individualism has found wide acceptance not only in the political thought but in the practical politics of both the United States and England during the past hundred and fifty years. Even today it is the dominant political philosophy of an influential portion of our population in this country, particularly certain captains of industry and members of the legal profession. Briefly, it stands for the divorce of government from business; it glorifies individual initiative; and it seeks to allow the fullest possible individual development unhampered and unhindered by restrictions of the state. The French expression, *laissez faire*, summarizes excellently and briefly the essence and spirit of individualism. In general, individualists regard government as an evil but conclude that society is better with than without it. Hence, the expression that government is a necessary evil has become associated with their theories.

The most outstanding exponents of individualism are the French Physiocrats and certain English writers of the eighteenth and nineteenth centuries, notably, Jeremy Bentham, John Stuart Mill, Herbert Spencer, and Adam Smith. The various individualistic theories have started with different premises and reached different conclusions, but all have disapproved of governmental interference or regulation.[1]

The economic aspects of individualism find expression in the writings of Adam Smith and the French Physiocrats. In his "The Wealth of Nations," Adam Smith advocates the principle of

[1] "Theory of Legislation" by Jeremy Bentham, Chaps. I–XIII; "Social Statics" by Herbert Spencer; "On Liberty" by John Stuart Mill.

free competition.[2] Like Smith, the French Physiocrats advocate freedom of competition. One of their number, François Quesnay, writes as follows:

> Let absolute freedom of commerce be maintained; for the surest guardian of internal and external commerce, the most exact and profitable to the Nation and State, lies in the unlimited freedom of competition.[3]

In Herbert Spencer, the last of the great individualist philosophers, we find the most extreme type of individualism. In fact, it verges upon anarchism. Spencer believes that the important thing for man is happiness. Man's happiness can be secured only by the exercise of his faculties to the utmost, and to achieve this end he must have a maximum of liberty. According to Spencer, as God intended that man should have liberty, man has a right to liberty.[4] Even Spencer admits that because of the existence of other human beings, there must of necessity arise limitations upon the liberty of the individual. He concludes that each person can claim only the fullest liberty to exercise his faculties which is compatible with the possession of like liberty by every other person.[5]

Spencer believes in the state but only as a necessary evil. Although the existence of the state must result in curbing the individual's freedom to a certain extent, it insures a more equitable distribution of liberty. Without the state, one person may have greater freedom, but another much less. Spencer, unlike Bentham, however, contends that the functions of the state should be reduced to the bare minimum. According to him, the sole function of the state should be to protect the individual against the wrongs of his neighbor or the violence of some foreign state. All other things should be left to individuals or organizations. If the state performs other tasks, it cannot properly perform what Spencer believes to be its true function. "To each organ one function and only one." The state should not interfere in commerce since such interference violates rights,

[2] "The Wealth of Nations" by Adam Smith, Chap. II of Book IV.

[3] "Maximes générales de gouvernement économique d'un royaume agricole" by François Quesnay, Maxim XXV.

[4] "Social Statics" by Herbert Spencer, Chap. IV, Sec. 2.

[5] "Social Statics" by Herbert Spencer, Chap. IV, Sec. 3.

and it is the duty of the state to protect rights. Even the coining of money should be left to private persons, the state merely enforcing any obligations which arise therefrom.[6]

During most of the nineteenth century in both England and the United States, individualism was the economic and political philosophy of a great majority of industrialists, judges, and lawyers. They believed that the government should keep out of business. Individuals should be allowed to deal freely with one another. Business should be permitted to develop unfettered or unhampered by governmental interference. The government should not enact child labor laws, minimum wage laws, or social insurance legislation. The government should not regulate service or rates of businesses affected with a public interest. Such legislation, they believed, interfered with the normal healthy growth of commerce and industry. James C. Carter, at one time leader of the American bar, expressed his faith in individualism in the following words:

> There is a guide which when kept clearly and constantly in view, sufficiently informs us what we should aim to do by legislation and what should be left to other agencies. This is what I have so often insisted upon as the sole function both of law and legislation, namely, to secure to each individual the utmost liberty which he can enjoy consistently with the like liberty to all others. . . . To leave each man to work out in freedom his own happiness or misery, to stand or fall by the consequences of his own conduct, is the true method of human discipline.[7]

Under the "benevolent" influence of individualism, the factory system developed. Industries grew, prospered, and escaped regulation. In the United States, giant corporations secured monopolistic control. Under the influence of individualism the evils of railroad rebates and manipulation of railroad securities flourished unchecked and philosophically justified. When the menace to individualism reached legislative halls, the fight was transferred to the courts, which obligingly reached into the Constitution and, finding the Fourteenth Amendment, gave it a "substantive" twist, thereby prolonging the life of individualism despite the heroic efforts of Justice Holmes and his distinguished associate dissenters.

[6] "Social Statics" by Herbert Spencer, Chaps. XXI–XXV.

[7] "Law: Its Origin, Growth, and Function" by James C. Carter, p. 337.

Individualism may be justifiable in an agricultural or pioneering community wherein each individual or each family lives largely unto itself, produces and consumes most of its products, and wants little more than to be protected. In such a state there is ample place for a rugged individualism. As society has become more complex and individuals more interdependent, individualism has been forced to give way philosophically and practically to something more befitting the great industrial society of modern times. One should not imagine that individualism is dead. On numerous occasions during the past few years, distinguished industrialists, legislators, and judicial and executive officials have given public utterance to individualistic dogmas, orthodox enough to satisfy the most ardent followers of Herbert Spencer. When such persons have talked about the true function of government, they have implied, usually, that the government should confine its activities to protection. However, the individualism that is now advocated is little concerned with the freedom of the individual, but is eager to prevent governmental interference with group or corporate action. It is violently opposed to laws or governmental machinery which stand in the way of freedom of action on the part of economic groups or corporations.

Whether individualism offers any contribution to the solution of the problem of social and economic planning is a question. To a certain extent it does. Industries, even though unregulated, may possibly avoid some of the follies of overproduction if they have monopolistic control; or they may eliminate wasteful or unethical practices. Self-regulation has certain great disadvantages, however. In the first place, it usually aims at securing a maximum profit rather than at satisfying the reasonable needs of society; or at eliminating practices which all members agree are wasteful or injurious to the trade rather than at eradicating practices which are merely socially undesirable. In the second place, unless self-regulation is reinforced by the government, there is always the possibility that some member of the group will violate the agreement in order to gain a special advantage, or that some outsider will enter the field and upset the plan. Self-regulation has this advantage: it is sometimes easier to enforce than regulations which are imposed by the government contrary to the wishes of the parties concerned.

II. Collectivism.

Collectivism stresses social interests and welfare and regards the state not as a necessary evil but rather as a desirable institution whose duty it is to undertake new functions and services, to prohibit certain conduct, to aid or regulate business, and to interfere with the rights and freedom of the individual whenever, by so doing, such action will promote the welfare of a large group or of society as a whole.

Since the latter part of the nineteenth century both philosophical and practical individualism have been giving way gradually to collectivism. The social and economic consequences of extreme individualism have become obvious in both the United States and England. It has become more and more evident that, whatever merit such a theory may have had for a pioneer or agricultural society, it has not met the needs of a society which has become complex and highly industrialized.

This change in attitude is reflected in the writings of many of the leading economists and political thinkers of modern times. Henry Sidgwick in his "The Principles of Political Economy" points out and justifies instances of governmental interference.[8] More recently, Léon Duguit in his "Law in the Modern State" has expounded a thesis which gives a philosophical basis for collectivism. He believes that a certain group of persons in a state have the power to govern and correlative with this power is a duty to perform public services. A public service is defined by Duguit as any activity which must be governmentally regulated and controlled in order to produce social solidarity. In other words, whatever is essential to the smooth running of society is a public service.[9] Obviously the concept of a public service is not fixed but must alter as times and conditions change. In a pioneer or nonindustrial society the individual and his family are almost self-sustaining. For light they use a candle or lamp. They draw water from their own well. Transportation is performed by oxen or horses. Almost the only thing they demand or need from the state is protection and the preservation of order. With the change to an industrial society their position becomes materially altered. Their food supply comes to them by means of transportation facilities which are not

[8] "The Principles of Political Economy" by Henry Sidgwick, pp. 527–531.
[9] "Law in the Modern State" by Léon Duguit, Part IV of Chap. XI.

under their control. For such indispensable things as light and water they must depend upon other persons. By virtue of changed circumstances, the furnishing of light, water, and transportation become public services. Nor does this exhaust the list of enterprises which because of their importance ought to be placed in this special category. According to Duguit it is the duty of the government to assure continuous and adequate supplies of these services at reasonable rates.

In practice as well as in theory collectivism has found expression. So far as its relationship to business is concerned, it has manifested itself in the United States in three ways, (1) aid to business, (2) regulation of business, (3) development of cooperatives.

In its aid to business the government of the United States has been generous indeed. Through the Bureau of Standards, the Bureau of Foreign and Domestic Commerce, and a score of other agencies, Uncle Sam has conducted experiments and gathered information of value to commerce and industry. By the payment of high compensation for the carrying of mail by airplanes and steamships, the United States has given a subsidy to these forms of transportation. One of the most striking illustrations of assistance which the government has afforded to business is the Reconstruction Finance Corporation. Through this agency millions of dollars have been loaned by the government to railroads, banks, and insurance companies at a time when borrowing from other sources would have been difficult.

The regulation of business in the United States has taken many forms. Sometimes governmental authorities have tried to force companies to compete in order that the public may be protected against the effects of monopoly and restraint of trade. The Sherman Antitrust Law is the outstanding illustration of control of this type. Sometimes governmental authorities have sought to purge business of unfair methods of competition. It was to achieve this end that the Federal Trade Commission was created in 1914. Sometimes governments have sought to protect the public against dishonest, fraudulent, or other injurious practices on the part of certain businesses. The pure food and drug acts and the "blue sky" laws prohibiting the issuance of fraudulent securities are illustrations of collectivism of this type. Sometimes governments have allowed monopolistic control to certain

industries and then imposed restrictions as to rates, services, consolidations, and other phases of their businesses. The regulation of railroads, stockyards, electric, gas, and telephone utilities furnish illustrations of collectivism of this type.

Collectivism as represented by government aid and control of business can, if successful, prevent many of the undesirable features of an unregulated society. It is impossible, however, to make sweeping assertions as to its probable success or failure. Such phases as have been tried have sometimes proved successful and sometimes not. The efforts to prevent monopoly and restraint of trade have not been crowned with success. Yet the government must be credited with improving the food supply of the United States through inspection of meats and legal safeguards against adulterated and misbranded foods.

The success or failure of regulation depends upon many factors. One of the most important is the existence of a competent and impeccable governmental agency. Another is the extent to which the regulated parties cooperate. If they are hostile, the task is extremely difficult; but if they are willing, it is greatly simplified. The attitude of the public is another important factor. Strong public opinion in favor of a law can materially assist the regulatory agent. The attitude of the courts has much to do with the success or failure of a scheme of control. If a court is unsympathetic toward a particular kind of control or meticulously literal in its interpretations of a statute, it can cripple, in fact almost nullify, the efforts of a regulative agent. An excellent illustration is to be found in the efforts of the Federal Trade Commission to prevent price discriminations, exclusive dealing arrangements, or stock acquisitions by corporations. On one occasion after another the courts have overruled decisions of the commission, until they have nearly paralyzed it in its attempts to stamp out these practices. Furthermore, a regulatory scheme to be effective should not be delayed until the evils of *laissez faire* have reached great magnitude. An excellent illustration of this is to be found in the case of railroads. Railroad building and railroad financing for a long period of time were subject to no restrictions. The practices followed by the carriers during that period have undoubtedly been the cause of some of their subsequent financial difficulties. Furthermore, a regulative scheme cannot be effective unless

comprehensive. That is, if one industry is regulated, allied industries should be subjected to proper supervision. Again the railroads furnish an illustration. In the past few years other methods of transportation, the bus, the truck, the airplane, and the private automobile have developed. The problem of effective railroad regulation has been inextricably bound up with the problem of control over other types of carriers. Yet the Federal government until recently imposed almost no restrictions on these other carriers. Finally, if collectivism is to be successful, the governmental regulations which are imposed should not be so stringent as to stifle completely private initiative.

It is a grave question whether a political system such as that of the United States is well suited to effective regulation. Fascist Italy is likely to achieve it more readily than the United States with its doctrine of judicial review, its theory of division of powers between the federal government and the states, and its emphasis upon democracy and individual rights.

The cooperative movement is another form of collectivism which in some countries has been used as a method for the control of business. There are many kinds of cooperatives but, generally speaking, they can be classified into two large groups, producers' cooperatives and consumers' cooperatives. In the case of producers' cooperatives, workers, farmers, or other producers organize cooperative business ventures to sell the products which they have produced, thereby reserving for themselves a greater share of the profits. In the case of consumers' cooperatives, consumers organize business enterprises such as retail and wholesale grocery stores, gasoline filling stations, or other businesses to furnish themselves at reasonable prices with certain of the products which they urgently need as consumers. In either case, the effect of the organization and operation of cooperatives has been to regulate private business through competition.

III. Socialism.

Socialism is sometimes considered as a species of collectivism. It is true that socialism and collectivism have somewhat the same purposes, both stressing the welfare and interests of society rather than the rights and interests of the isolated individual. Socialism holds that the interests of the group will be best served

if the state plays a more direct and important part than it does under the capitalist system. The advocates of socialism do not believe that the public can be adequately protected against exploitation under a system of private ownership and government regulation.

Socialist theory assumes a great variety of forms, but in the main its advocates have a few cardinal principles around which they build their philosophy. Socialists propose that the instruments of production shall be organized and managed by society. Most of them advocate distribution of social income among individuals according to some plan which will secure more equality. Socialism must not be confused with communism. Communism advocates the abolition of private property in consumption as well as in production goods. Socialism, on the other hand, does not advocate the complete abolition of the institution of private property but permits private property in income.

As previously stated, there are many kinds of socialism. This discussion will not include all of them, but merely select and treat briefly a few of the most important types.

One of the least radical kinds is "state socialism." Advocates of this favor an extension of state authority into the economic field through public ownership and operation of certain industries; but they do not propose any fundamental changes in existing class relations. This theory has found some support and practical application in Germany, Australia, and New Zealand. Many proletarian socialists are very hostile toward state socialism. They contend that when public ownership takes place in a bourgeois state without changing the class relationship, it merely increases the possibilities for oppression of the working class. Since they regard the existing state as an instrument of domination and oppression of the proletariat, they argue that to increase its power merely increases its weight.[10]

One of the best known kinds of socialism is "Marxian socialism," or, as it is sometimes called, "scientific socialism." Karl Marx, its founder, has not given us a systematic outline of the political or economic organization which is to supplant the present

[10] See p. 57, "The Marxian Theory of the State" by Sherman H. M. Chang.

state, but he has enunciated certain cardinal principles upon which other socialists and even communists have built their systems. The first of his doctrines is the economic interpretation of history. According to Marx, our entire life, our ideas of marriage, politics, art, and even religion are the results of our economic conditions either past or present. The second is his labor theory of value. According to this, labor is the source of all value and should therefore be entitled to all it produces. The capitalist system, however, takes the difference between the value which is created by labor and that which is received by labor. The third important principle is his doctrine of class struggle. In this he holds that the laborer and the capitalist have nothing in common but are fundamentally and definitely antagonistic. He thinks that ultimately this must result in the overthrow of the capitalist. The fourth principle is the concept of society as an evolutionary product. He predicts that capitalism will inevitably disappear; that industry, agriculture, and commerce will be conducted on an ever larger scale, thus throwing small proprietors into the ranks of the proletariat; that inequalities in wealth will increase; that the condition of the working class will become more and more miserable; that crises will become worse; and that finally in desperation the masses will rise and take over the capitalistic enterprises.[11]

Another type, Fabian socialism, has centered about certain English intellectuals, such as George Bernard Shaw, Graham Wallas, Harold J. Laski, and Sidney and Beatrice Webb. The organization which has been instrumental in spreading their doctrines is the Fabian Society. The Fabians believe that socialism can be achieved by evolution and accordingly have championed many reform measures which are in harmony with their principles.

Guild socialism differs somewhat from the other kinds of socialism in that it advocates the organization of society into guilds or groups. In its organization of society it bears some resemblance to Syndicalism, a movement which has many followers on the continent of Europe, but does not emphasize the general strike, sabotage, or revolution as does Syndicalism.

[11] For a statement of these fundamental doctrines of Marx, see p. 180, "A History of Political Theories in Recent Times" by C. E. Merriam and H. E. Barnes; also p. 629, "Outlines of Economics" by Richard T. Ely, 5th ed.; also "The Marxian Theory of the State" by Sherman H. M. Chang.

At the summit of the guild socialist organization is the "commune," which is to take the place of the present state. The commune would be much less important than the state of today, confining its functions largely to the settlement of controversies between the various groups and the conduct of foreign relations with other similar organizations. Most of the present political and social functions would be performed by groups or guilds. All workers by hand or brain in a given industry would organize and operate their industry. Consumers' guilds would represent and protect the interests of consumers. Civic service councils would undertake certain functions now performed by local governments, such as education and the protection of health.[12]

Undoubtedly socialism is able to bring serious indictments against the present system. It points to overproduction and needless duplication; to the costs of advertising and the employment of salesmen whose functions are to force goods on unwilling purchasers; to restrictions of production by well-organized industries in order to secure maximum profits; to the complicated and wasteful system of distribution which enhances tremendously the cost of commodities to the ultimate consumer. Finally, it points to the inequitable distribution of wealth, which continues not only during the life of individuals but through successive generations. Many of these indictments are well founded. One should remember, however, that most of them have developed under individualism rather than collectivism.

It is a grave question whether or not the remedies proposed by socialism would bring with them evils which are worse than those which they would annihilate. For one thing, socialism must provide an adequate substitute for the present system of economic rewards and profits. Perhaps too much emphasis has been placed on this as a motive or stimulus to economic progress, but one cannot deny that it has been an important factor. A substitute must be found if we are to have assurance of a continuance of economic progress. Undoubtedly there are motives other than profit to which an appeal can be made. Men have been stimulated in the past by religion, patriotism, fear, or social disapproval. To find and cultivate the necessary substitutes would require drastic changes in social ideals and values. New generations which have not been inculcated with existing eco-

[12] See "Guild Socialism Restated" by G. D. H. Cole.

nomic doctrines and prejudices would have to be reared and educated. Another objection to socialism is the size of the industrial and economic machinery which it would create. Obviously, socialism would involve much delegation and separation of functions.

Too much weight should not be given to the academic arguments for and against socialism. Whether or not one approves, it is possible that socialism in one of its many forms will supplant our system of private ownership and operation. Certain phenomena seem to point to this. One of them is the growth and concentration of industry. As business grows in size, the necessity for regulation on behalf of the public increases. At the same time, the difficulties of regulation seem to increase. The increase in the financial strength of a business better enables it to frustrate efforts at regulation. If large corporations and groups consistently try to prevent effective governmental control, the state may be forced to take them over or to enter the field as a competitor in order to protect the public interest. Another thing which may tend to bring on a socialist regime is the recurrence of economic depressions, which seem to be inevitable under our present competitive system. Unless capitalism in conjunction with the state can successfully prevent these, the masses who suffer most in such periods may rise in desperation and establish a socialist state. Finally, the condition of some essential industries may force the government in the direction of socialism. If certain important industries, such as railroads or coal mines, cannot be operated so as to give a sufficient profit to private capital and a satisfactory reward to labor, the government may be forced to undertake their ownership and operation.

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CHAPTER II

CONSTITUTIONAL LIMITATIONS UPON THE CONTROL OF BUSINESS

At the outset of any discussion of the control of business by government, one is confronted with possible constitutional limitations. Although it may be desirable for government to increase its control of business either through regulation or ownership and operation, actual attainments may be difficult because of constitutional provisions. Probably nowhere in the world is the question of such limitations more important than in the United States. We have developed in this country many important constitutional principles which stand as barriers to plans for government control. One of these is the doctrine of judicial review; another is the theory of division of powers between states and the United States; a third is the concept of "substantive" restrictions upon the legislative bodies under the provisions of the "due process clauses" of the Fifth and Fourteenth Amendments; and the last is the constitutional provision which forbids the states to impair the obligation of contract.

I. Judicial Review.

The first of these, the doctrine of "judicial review," which allows the courts to check the legislative branch of government when it exceeds its constitutional authority, must be regarded as a very decided barrier to centralization. Had the doctrine of "judicial review" not developed as it has in the United States, undoubtedly legislative authorities would not find their field of legislation so restricted. If, for example, the doctrine had developed that the Federal courts might declare state laws unconstitutional in case they infringed powers given to the central government, but could not under any circumstances question acts of Congress, the Constitution would then be little more than a code of political morality which Federal legislators might hesitate to transgress.

Even though the doctrine of judicial review has apparently impeded centralization, one must admit that the courts have allowed expansion of the powers of the Federal government far beyond what was probably the intention of most of the framers of the Constitution. Starting with fundamental limitations imposed by representatives of sovereign states which were jealous of loss of authority, restricted by the customary caution of the judicially minded, and bred in the atmosphere of the common law with its reverence for precedent, the wonder is that the judges of the Federal courts have made of the Constitution such a living and workable document. They have, of course, been aided by the very vagueness of much of its terminology. Specific and detailed provisions might have proved far more serious handicaps than more general terms. The framers of the Constitution could not possibly have foreseen the tremendous economic and social developments which were to occur. If, for instance, they had attempted to define commerce, possibly they would have mentioned transportation by stagecoach or by sailboat, but they would certainly have neglected to specify transportation by railroad, motor bus, or airplane, or communication by telephone or radio.

II. Division of Powers.

The second barrier is the division of powers between the states and the United States. To the central government, the Constitution gives *delegated* powers; to the states, *residuary* powers. This division of powers is undoubtedly an obstacle to effective control. The United States may control business only to the extent of its delegated powers, and the states in their attempts to regulate business must exercise care lest they invade the field which belongs to the Federal government.

Although the powers which the Federal government exercises must be delegated by the Constitution, they are not all of the same kind. Some of them are *express*, others *implied*, and others are *resulting* powers.

Express powers, as the word indicates, are those which are specifically mentioned in the Constitution. Those which bear upon the relationship of the government to business are not numerous. Most of them are found in Article I, Section 8. The first and most important of these is the commerce power.

From it, Congress derives its authority to regulate commerce among the states, with foreign nations, and with the Indian tribes. Although at times the "commerce clause" has been narrowly construed, so that some things have been excluded which by liberal interpretation might have fallen into the category of commerce, on the whole the Supreme Court has been quite liberal. The Supreme Court has permitted the growth and enlargement of this power to an amazing extent. Under the provisions of the "commerce clause," Congress has enacted laws regulating navigation, railroads, monopoly and restraint of trade, aviation, and even radio communication. To most of the framers of the Constitution, this expansion of national authority would be unbelievable. Extensive as is the present control, however, Congress has by no means exhausted the enormous potentialities of the commerce clause. Many phases of foreign and interstate commerce have not been touched, nor have the depths been sounded of others which have been the subject of some regulation. There are a host of possibilities for expansion even under the existing decisions of the Supreme Court.

Perhaps the express constitutional provision which ranks next in importance to the commerce clause is the "taxing clause." Under its provisions, Congress is given the power to lay and collect taxes, duties, imports, and excises, to pay the debts, provide for the common defense, and provide for the general welfare of the United States. As far as the relationship of the Federal government to business is concerned, it is doubtful whether the potentialities of this clause are fully realized by the average person. It has both a negative or restrictive aspect and a positive or expansive side. On its negative side, it offers the opportunity for the Federal government to regulate or extinguish business. Examples of this are the 10 per cent tax which the Federal government has imposed upon colored oleomargarine in order to annihilate traffic in this product, and the 10 per cent tax which the United States has placed upon state bank notes in order to drive them from circulation. Even more important are the provisions of the tariff, which have the effect of regulating and even smothering a vast amount of import business. On its positive side, this clause has enabled the United States to raise money and expend it for any purpose which can be construed as coming within the meaning of the expression, "the

general welfare." Under its broad provisions, the United States has raised and expended money for the establishment of a host of bureaus which are designed to be of aid and assistance in gathering information, collecting statistics, and conducting experiments of importance to commerce and industry. Observe, for example, the efforts of the Bureau of Foreign and Domestic Commerce, the Bureau of Standards, the Conciliation Service, the Census Bureau, and a score of others. Under the broad provisions of the taxing clause the United States has raised money and used it for the benefit of business. Even though the Federal government does not have the power to *regulate* all business, there seems to be no limitation upon its authority to raise and spend money in ways which will be beneficial to any kind of business.

The authority conferred upon Congress to borrow money on the credit of the United States is another important express power. There seem to be almost no limits to the uses to which such money can be devoted. Under the broad grant of power to borrow money, the Federal government appears to have authority to use such money to aid farmers, banks, or railroads, or to establish bureaus which gather information or conduct experiments for business.

The broad statements of the "taxing clause" and the "borrowing clause" give to the Federal government plenty of scope for embarking upon a program of ownership and operation of various business enterprises. If the United States can tax for the general welfare and can borrow for almost any purpose, there seems to be no logical reason why it cannot establish or buy business enterprises to be operated by Federal authorities. May it not be possible for the United States to tax or borrow for the establishment and operation of a gigantic power plant, a fleet of ships, or a railroad system? May it not even engage in businesses which probably cannot be regulated under the present judicial interpretation of the commerce clause; for example, the business of insurance? On one pretext or another the Federal government has already entered several fields of business. The buying and selling of grain and the erection and operation of the Alaskan Railroad are two illustrations. As long as the Federal government may tax, borrow, and spend the money to promote the general welfare, there seem to be few constitutional obstacles

to Federal ownership and operation of business enterprises. In other words, the ownership and operation by the United States seems to be an easier matter from a purely constitutional point of view than extensive Federal regulation.

There are numerous other express powers which give to Congress some authority over business. The power to establish post offices and post roads has enabled the United States to engage in its biggest business enterprise. Congress has authority to establish uniform laws on the subject of bankruptcies throughout the United States. Power is given to the Federal government to control patents and copyrights by the provision that Congress may promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their writings and discoveries. Also, Congress has the power to coin money and regulate the value thereof. Furthermore, Congress may fix the standards of weights and measures. Finally, the treaty-making power and the war power should be mentioned as possible sources of Federal authority to regulate business.

It is unnecessary that all delegated powers be expressly mentioned in the Constitution. Very early in the history of the United States, the Supreme Court, under the guidance of Chief Justice John Marshall, enunciated the doctrine that the Federal government had implied as well as express powers. This doctrine was expounded in the famous case of *McCulloch v. Maryland.*[1] The State of Maryland forbade banks which were not chartered under its authority to issue bank notes, except upon specially stamped paper on which there was a heavy state tax. If such banks paid an annual tax to the state, it was unnecessary to comply with the above-mentioned requirement. Certain penalties were provided for disobedience. The cashier of the Bank of the United States which was established at Baltimore issued notes without complying with the law. The State of Maryland sued to recover the statutory penalties. The question which the Supreme Court had to decide at the outset was whether or not Congress had the power to establish a national bank. No express authority could be found in the Constitution. The court held, however, that Congress had the implied power to establish this banking institution. It was pointed out that at the end of

[1] (1819) 4 Wheat. 316, 4 L. Ed. 579.

Article I, Section 8, was the so-called "elastic clause" which gave to Congress the power to make all laws necessary and proper for carrying into execution the preceding express power. This clause the Court felt was expansive rather than restrictive in that it enabled Congress to choose any means for carrying out the express powers. The establishment of a national bank was one means of successfully carrying out the power to borrow money, to tax, to raise and support armies, to declare war, and to regulate foreign and domestic commerce.

Thus it can be seen that Congress enjoys *implied* powers which are derived from one or more express powers. The most important of these is the power of the Federal government to establish and regulate national banks. The power of Congress to forbid the shipment of certain commodities through the mails is implied, since the express authority conferred by the Constitution upon Congress is confined to the establishment of post offices and post roads. Also, some of the regulations of interstate commerce depend upon the doctrine of implied powers, for they can scarcely be justified under the express statement of the commerce clause. The importance of the doctrine of implied powers to the Federal government is tremendous. Without it, central control would be confined within very narrow limits. It offers a great field of potential regulatory authority which, for the most part, has been uncharted and unexplored.

The doctrine that Congress enjoys *resulting* powers has occasionally been advanced. The exact nature or the limit of these is impossible to ascertain. In fact, the whole concept is vague and indefinite, for the courts have seldom had occasion to discuss the question. Sometimes the term "resulting power" is used to indicate a power which can be implied from all of the Federal powers as distinguished from an implied power which is derived from one or more of the express powers.[2] The concept of resulting powers is interesting because of the possibilities which it contains for federal expansion.

III. Due Process of Law.

The third barrier to extensive control of business is the provision which forbids the taking of property without due process

[2] For a brief discussion of "resulting powers," see p. 89 of "The Constitutional Law of the United States," 2d ed., by W. W. Willoughby.

of law. This provision is found at two places in the Constitution of the United States, the Fifth Amendment and the Fourteenth Amendment. In the Fifth Amendment a limitation is imposed upon the Federal government, and in the Fourteenth a limitation is imposed upon the states.

To what extent the "due process clause" constitutes a serious limitation upon the power of Congress to regulate business is impossible to say, as the courts have almost invariably seen fit to uphold the validity of a Federal regulation alleged to be in violation of the Fifth Amendment. We do know, however, that its counterpart, the Fourteenth Amendment, in its substantive aspect has proved a very serious limitation upon the power of state legislatures to control business.

The due process clause of the Fourteenth Amendment does not completely prohibit the states from exercising control over business. Under their police power, the states may protect the health, morals, safety, and general welfare of the public. The degree of control which is possible varies with the nature of the business. Over all businesses, even those which are ordinarily designated as private, the states may exercise some control. For example, a state may impose restrictions which are designed to prevent frauds on the public, may inspect foods and meats to ascertain their purity, may license drug stores to protect the health and safety of citizens, or may require factories and mines to adopt devices to safeguard their employees. However, any such regulations must be reasonable and likely to achieve the desired end. This is well illustrated by a decision of the Supreme Court of the United States holding a statute of Pennsylvania unconstitutional. Among other things the statute required all stockholders of corporations which owned drug stores to be licensed pharmacists. The court declared that although the act might be regarded as one which was designed to protect the health of the citizens of Pennsylvania, the method of attaining the end was unreasonable since there was no substantial relationship between the ownership of stock and public health.[3]

Over certain kinds of businesses the states may exercise even more drastic control, namely, those businesses which are "affected with a public interest." Here the states may, under their police power, limit the number of persons or corporations which engage

[3] Liggett v. Baldrige (1928) 278 U. S. 105, 73 L. Ed. 204, 49 S. Ct. 57.

in the business; regulate the rates charged and the services rendered; prescribe and police their accounts; control mergers, consolidations, and the issuance of stocks and bonds. However, businesses which are subjected to these more drastic regulations must bear a close relationship to the general welfare. The courts have had considerable difficulty in ascertaining what businesses are subject to these drastic regulations. Obviously, railroad, electric, gas, telephone, or water companies can be regulated. On the other hand, the Supreme Court of the United States held that employment agencies, the buying and selling of theater tickets, and the selling of gasoline could not be subjected to rate regulation, and that persons engaged in the manufacture and sale of ice could not be required to obtain certificates of convenience and necessity.[4] More recently the Supreme Court upheld the validity of state regulations fixing the minimum retail prices for milk.[5]

Finally, when it is necessary to protect the health, morals, or safety of the public, states under their police power may prohibit altogether certain kinds of businesses without violating the Fourteenth Amendment. Thus the state may forbid the manufacture and sale of intoxicating liquor or the operation of a lottery.

The question arises as to whether or not the due process clause of the Fourteenth Amendment imposes any limitation upon the power of the states to engage in government ownership and operation of business enterprises. Probably the only limitation is the rule that states may not tax except for a public purpose. However, the courts have been quite liberal in their concept of public purpose. Thus, the Supreme Court of the United States upheld the action of North Dakota in establishing a state bank, mills, elevators, warehouses, and other allied businesses.[6] In another case, a state court permitted a municipality to borrow money to establish and operate an ice plant.[7]

[4] Tyson and Bros. v. Banton (1927) 271 U. S. 418, 71 L. Ed. 718, 47 S. Ct. 426; Ribnik v. McBride (1928) 277 U. S. 350, 72 L. Ed. 913, 48 S. Ct. 545; Williams v. Standard Oil Co. of La. (1929) 278 U. S. 235, 73 L. Ed. 287, 49 S. Ct. 115; New State Ice Co. v. Liebmann (1932) 285 U. S. 262, 76 L. Ed. 747, 52 Sup. Ct. 371.

[5] Nebbia v. N. Y. (1934) 291 U. S. 502, 78 L. Ed., 940, 54 S. Ct. 505.

[6] Green v. Frazier (1920) 253 U. S. 233, 64 L. Ed. 878, 40 S. Ct. 499.

[7] Holton v. City of Camilla (1910) 134 Ga. 560, 68 S. E. 472.

IV. Obligation of Contract.

Article I, Section 10, of the Constitution of the United States provides that no *state* shall pass any law impairing the obligation of contract. To a certain extent this provision has proved a barrier to the control of business by the states. It forbids the states to pass laws which alter the terms of existing contracts between individuals or corporations. It also forbids the states to impair the obligations of contracts which they have with private persons. In the Dartmouth College case, the Supreme Court of the United States held that a charter of incorporation was a contract between the state and the private persons who were parties thereto.[8] In other cases, the courts have held that franchises between public utilities and cities are contracts. Any attempt of the state to regulate corporations by altering the terms of a charter or franchise runs the danger of being declared unconstitutional as a violation of the "contract clause" of Article I, Section 10.

Although the contract clause has sometimes prevented a state from exercising control over business, its limitations have been mitigated by the rule that the states under their police power may sometimes impair the obligation of contracts when it is necessary to protect the health, morals, safety, or general welfare of the public. Thus the state can forbid lotteries or the traffic in intoxicating liquors even though in so doing it renders the charters of companies engaged in these businesses valueless and impairs the obligations of numerous private contracts in relation thereto.[9] Or in periods of economic difficulties, the state may as an emergency measure postpone the date for the foreclosure of mortgages.[10]

References

Constitution of the United States, Art. I, Sec. 8.
McCulloch v. Maryland (1819) 7 Wheat. 316, 7 L. Ed. 579.
"Constitutional Law of the United States" by W. W. Willoughby, 2d ed., p. 89.

[8] Trustees of Dartmouth College v. Woodward (1819) 4 Wheat. 518, 4 L. Ed. 629.

[9] Stone v. Miss. (1880) 101 U. S. 814, 25 L. Ed. 1079; Mugler v. Kan. (1887) 123 U. S. 623, 31 L. Ed. 205.

[10] Home Bldg. and Loan Ass'n. v. Blaisdell (1934) 290 U. S. 398, 78 L. Ed. 413, 54 S. Ct. 231.

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CHAPTER III

THE COMMERCE CLAUSE OF THE CONSTITUTION

In any discussion of the control of business by the Federal and state governments, the "commerce clause" of the Constitution must occupy a prominent place. It is unquestionably the most important grant of authority to control business which Congress enjoys. Without the commerce clause, almost the entire burden of such control would rest upon the states.

The Constitution has not given the Federal government the power to control all business. For one thing, those transactions which are not commerce or closely related thereto have been left to the states. For another thing, the Constitution divides even the control of commerce between the Federal and the state governments by giving to Congress the power to regulate interstate and foreign commerce, and leaving to the state legislatures the power to control intrastate commerce.

Although the entrusting of some of the regulation of business to the states has certain advantages, especially in the control of purely local matters, the division of powers provided by the Constitution has caused numerous complications and at times has proved a serious barrier to effective regulation. In the first place, the line of demarcation between transactions which are regarded as commerce and those which are not is exceedingly hard to draw. The distinction between interstate and intrastate commerce has been even more difficult to ascertain. Such difficulties have provoked much litigation, have given rise to many judicial inconsistencies and absurdities, and have been productive of uncertainty. All too often, business, realizing this situation, has sought to escape regulation by running to the courts with the plea that the unwanted legislation is a violation of the commerce clause.

In the second place, the division of powers has made for great diversity in the control of commerce and industry. A certain amount of diversity is undoubtedly desirable but not when it descends to the level of mere competition in laxity. Certain

states have purposely relaxed their laws in order to induce corporations to do business within their borders. Such practices have made it difficult for the United States and other states to enforce legislation designed to stamp out operations regarded as unsocial or inimical to public welfare.

I. The Concept of Interstate and Foreign Commerce.

Since the commerce clause does not delegate to the Federal government the power to control all business and industry, or even all commerce, it is essential at the very outset to determine what constitutes commerce and what commerce is foreign and interstate.[1] As the Constitution contains no definitions which would aid in clarifying these terms, reliance must be placed chiefly upon court decisions.

Since very early in our constitutional history, the term "commerce" has been understood to include the *buying and selling* of commodities.[2] If the buying and selling is a purely local transaction which takes place entirely within a state and is not part of an interchange or movement of commodities between states, it is not regarded as interstate commerce.[3] If, on the other hand, the buying and selling is part of an interchange of commodities between states it is interstate commerce.[4]

That commerce *includes* transportation has been understood since the famous case of *Gibbons v. Ogden.*[5] It is now the rule that commerce includes the transportation of persons, animals, or commodities. The means is immaterial, whether by railway, horse, or boat. In other words, by any means of transportation, natural or artificial, it is possible to engage in commerce. Nor does it matter whether the transportation is performed gratuitously or for hire. If the movement takes place between states, it is interstate commerce.[6] All persons and all instrumentalities,

[1] For a discussion of what is commerce and what is foreign and interstate commerce, see Chaps. IV and V of "The Commerce Clause of the United States Constitution" by Bernard C. Gavit.

[2] See the statements of the Supreme Court of the U. S. in the case of Gibbons v. Ogden (1824) 9 Wheat. 1, 6 L. Ed. 2.

[3] Wagner v. Covington (1919) 251 U. S. 95, 64 L. Ed. 157, 40 S. Ct. 93.

[4] Robbins v. Taxing District (1887) 120 U. S. 489, 30 L. Ed. 695, 7 S. Ct. 592.

[5] (1824) 9 Wheat. 1, 6 L. Ed. 2.

[6] See Wilson v. U. S. (1914) 232 U. S. 563, 58 L. Ed. 728, 34 S. Ct. 347.

whether pipe lines, ferries, automobiles, or railways engaged in such transportation, are agencies of interstate commerce. That the persons or the instrumentalities do not pass beyond the boundaries of a state is immaterial. They are agencies of such commerce if they transport articles moving in interstate commerce. Thus, a boat company which operated upon water within a state but which carried goods moving between states was held to be engaged in interstate commerce.[7]

In recent cases, the courts have shown a disposition to regard general movements of commodities as interstate commerce.[8] For example, in one case the Supreme Court upheld the validity of Federal regulation of the buying and selling of live stock at the stockyards.[9] In another case, the court upheld Federal control of the buying and selling of grain futures. In both of these cases, the immediate practices were local but the court held that they were incidents of a general movement of commodities from state to state and therefore were subject to Federal control.[10]

Transmission of intelligence from state to state by telegraph, telephone, or radio is interstate commerce. Fortunately, the courts have decided that such communication is interstate commerce, even though they have had difficulty in finding a logical basis for so holding. At first, the courts held that a company operating a telegraph line between states was engaged in commerce because it performed an *indispensable service* to commerce.[11] In later cases, however, they decided that telegraph communication was commerce itself.[12] To prove that radio communication was commerce was especially difficult as there was nothing transported, no commodities bought and sold, nor anything directly connected with articles bought, sold, or transported. One court justified Federal regulation of radio upon grounds of political expediency:

Without such national regulation of radio, a condition of chaos in the air would follow, and this peculiar public utility, which possesses such

[7] The Daniel Ball (1871) 10 Wall. 557, 19 L. Ed. 999.

[8] Swift and Co. v. U. S. (1905) 196 U. S. 375, 49 L. Ed. 518, 25 S. Ct. 276.

[9] Stafford v. Wallace (1922) 258 U. S. 495, 66 L. Ed. 735, 42 S. Ct. 397.

[10] Board of Trade v. Olsen (1923) 262 U. S. 1, 67 L. Ed. 839, 43 S. Ct. 470.

[11] Pensacola Teleg. Co. v. Western Union Teleg. Co. (1877) 96 U. S. 1, 24 L. Ed. 709.

[12] Leloup v. Port of Mobile (1888) 127 U. S. 640, 32 L. Ed. 311, 8 S. Ct. 1380; Western Union Teleg. Co. v. Tex. (1882) 105 U. S. 460, 26 L. Ed. 1067.

incalculable value for the social, economical, and political welfare of the people, and for the service of the government, would be practically useless.[13]

The question of whether or not the business of insurance is commerce has come before the courts in several cases. The answer has always been that it is not, whether it takes the form of life insurance, fire insurance, or marine insurance.[14] The Supreme Court has declared that the issuing of policies of fire insurance is not commerce, that such contracts of insurance are not articles of commerce, that they are not the subjects of trade and barter, and that they are not commodities to be shipped or forwarded from one state to another. They are simple contracts of indemnity against loss entered into between the corporations and the assured.[15]

Mining, agriculture, and manufacturing are not commerce within the meaning of that term in the Constitution.[16] The courts have declared that neither the production nor the manufacture of articles is commerce in itself.

II. Federal Control of Interstate and Foreign Commerce.

The Federal government has plenary and absolute power to *regulate* foreign and interstate commerce. This power is subject to the limitation of the Fifth Amendment of the United States Constitution, which declares that property shall not be taken for public use without just compensation. Thus far, however, almost no legislation enacted under the commerce clause has been held unconstitutional as contrary to the Fifth Amendment.[17]

[13] Gen. Elec. Co. v. Fed. Radio Com. (1929) 31 Fed. 2d 630.

[14] Paul v. Va. (1868) 8 Wall. 168, 19 L. Ed. 357; New York Life Ins. Co. v. Cravens (1900) 178 U. S. 389, 44 L. Ed. 1116, 20 S. Ct. 962; Hooper v. Calif. (1895) 155 U. S. 648, 39 L. Ed. 297, 15 S. Ct. 207.

[15] Paul v. Va. (1868) 8 Wall. 168, 19 L. Ed. 357.

[16] Oliver Mining Co. v. Lord (1923) 262 U. S. 172, 67 L. Ed. 929, 43 S. Ct. 526; U. S. v. E. C. Knight (1895) 156 U. S. 1, 39 L. Ed. 325, 15 S. Ct. 249; Hammer v. Dagenhart (1918) 247 U. S. 251, 62 L. Ed. 1101, 38 S. Ct. 529; Kidd v. Pearson (1888) 128 U. S. 1, 32 L. Ed. 346; U. S. v. Butler (1936) 297 U. S. 1, 80 L. Ed. 477, 56 S. Ct. 312.

[17] P. 172, "The Commerce Clause of the United States Constitution" by Bernard C. Gavit, where the author declares that in only one case has Federal legislation enacted under the commerce clause been held invalid under the due process or liberty clause of the Fifth Amendment.

Not only may the United States government *regulate*, but it may also *prevent interference* with foreign and interstate commerce by parties who themselves are not engaged in commerce. This is well illustrated by cases brought under the Sherman Antitrust Law against members of labor unions for interfering with and restraining commerce between states through boycott.[18]

Although the Constitution of the United States gives to Congress full power to regulate and protect foreign and interstate commerce, Congress has subjected only a part of the field to Federal control. It has enacted considerable legislation controlling transportation and communication between states. The most extensive law of this character is the Interstate Commerce Act which regulates railroads, pipe lines, and express and sleeping-car carriers. Within the last few years Congress has undertaken the regulation of radio communication. There is much legislation regulating shipping and navigation and some regulation of transportation by airplane.

In addition to regulating transportation and communication between states, Congress has enacted statutes controlling other phases of foreign and interstate commerce. Through the Sherman Antitrust Act of 1890, the Clayton Law of 1914, and the Federal Trade Commission Act of 1914, it has tried to prevent monopolies, restraint of trade, and unfair methods of competition. In the Packers and Stockyards Act of 1921 and the Commodities Exchange Act of 1936, Congress has endeavored to stamp out certain practices which are regarded as injurious to commerce. The provisions of the Pure Food and Drug Act, the Meat Inspection Act, the Securities and Exchange Act, and the Trade-mark Act are further illustrations of congressional legislation under the commerce clause.[19] Finally, Congress has greatly extended Federal control of commerce by the passage of the National Labor Relations Act, which seeks to regulate labor relations.

III. State Control of Interstate and Foreign Commerce.

Although the commerce clause gives to Congress the power to control interstate and foreign commerce, it does not forbid the states to exercise some control over such commerce.[20]

[18] Loewe v. Lawlor (1908) 208 U. S. 274, 52 L. Ed. 488, 28 S. Ct. 301.

[19] For a discussion of this legislation see subsequent chapters.

[20] United States Constitution, Art I, Sec. 8.

Accordingly, the question of whether or not the states should be permitted any control over these phases has been left to the courts.[21] They have laid down the rule that the states through the exercise of their *police power* or their *taxing power* may enact legislation which affects such commerce.[22]

The Federal government may control the entire field of interstate and foreign commerce if it so desires, or it may leave a portion unregulated. In the absence of Federal legislation the states, under their *police power*, may regulate. However, all aspects of commerce unregulated by the United States are not proper subjects for the exercise of state authority. The power of the states extends only to foreign and interstate commerce which is *local* in character. This rule is well illustrated and expounded in the case of *Cooley v. Port Wardens of Philadelphia.* The State of Pennsylvania had enacted legislation regulating pilotage for boats entering and leaving Philadelphia. Since the law applied only to local foreign and interstate commerce, the Supreme Court upheld its validity.[23] If the subject is in its nature national or requires a uniform system of regulation, the states have no power to control even though the Federal government has no legislation pertaining thereto.

The doctrine that the state may control local aspects of interstate and foreign commerce has some arguments in its favor. Certain local conditions can best be met by local legislation. Where there are varying conditions, diversity rather than uniformity of regulation will often more effectively control and promote commerce. Furthermore, local authorities rather than central authorities are frequently in a better position to know whether any regulation is necessary or not and what regulation will best meet local needs.

Much state legislation is primarily designed as an exercise of the police power; that is, it is designed to protect the health, morals, safety, or general welfare of the people of the state, rather than to regulate or to aid interstate or foreign commerce. There is no objection to such legislation, provided, as one authority has stated:

[21] United States Constitution, Art. X.

[22] See the discussion on p. 244, "The Law of the American Constitution" by Charles K. Burdick.

[23] Cooley v. Port Wardens of Philadelphia (1851) 12 How. 299, 13 L. Ed. 996.

> . . . the state action constitutes a bona fide exercise of the police power, and does not unduly burden interstate commerce, and is not in conflict with any existing federal legislation.[24]

A number of cases involving conflicts between the police power of the states and the commerce power of the federal government have arisen. As a general rule, it has been held that the states do not have authority in the exercise of their police power to forbid the importation or the exportation of articles of commerce. In one case which arose before the adoption of the Eighteenth Amendment, an effort by the State of Iowa to prevent importation of liquor was held to be unconstitutional as it placed an undue burden upon interstate commerce.[25] In another case, certain restrictions which the State of Oklahoma placed upon the exportation of natural gas were held to be invalid as they conflicted with the commerce clause of the Constitution.[26] On the other hand, restrictions upon the importation of cattle from Louisiana as a quarantine measure against an outbreak of anthrax was held by the Supreme Court of the United States to be a proper exercise of the police power.[27] In another case, the State of Florida was held to have the power to prohibit the shipment of citrus fruit which was immature and unfit for human consumption.[28]

The general rule is that states may not by means of the *taxing power* place a direct burden upon foreign or interstate commerce. Although this rule greatly curtails the power of the states to tax, the reason for it is obvious. That the power to tax is the power to destroy is almost a legal platitude. If the states were allowed unlimited authority, they could seriously burden and even destroy commerce between the states.

The most obvious kind of tax which places a direct burden upon interstate commerce is a tax on goods or persons in the

[24] See "The Law of the American Constitution" by Charles K. Burdick, p. 245.

[25] Bowman v. C. and N. W. Ry. Co. (1888) 125 U. S. 465, 31 L. Ed. 700, 8 S. Ct. 689.

[26] West v. Kansas Natural Gas Co. (1911) 221 U. S. 229, 55 L. Ed. 716, 3 S. Ct. 564.

[27] Smith v. St. L. and S. W. Ry. Co. (1901) 181 U. S. 248, 45 L. Ed. 847, 21 S. Ct. 603.

[28] Sligh v. Kirkwood (1915) 237 U. S. 52, 59 L. Ed. 835, 35 S. Ct. 501.

course of transportation from state to state. Such a tax is unconstitutional.[29]

The states do not have unlimited power to tax the receipts of corporations engaged in interstate commerce. On this point, court decisions are hard to reconcile. It has been held that a tax upon gross receipts of companies engaged in interstate and foreign commerce is invalid.[30] On the other hand, in another case it has been decided that a tax upon the franchise of a company engaged in interstate and foreign commerce measured by gross receipts is valid as a kind of franchise tax.[31] These two cases seem to present a distinction without a fundamental difference. In either case the burden is there. The only difference is one of form. A tax levied upon the gross receipts derived from the interstate and intrastate operations of an express company within a state has been held valid where it is in lieu of all other property taxes.[32] Such tax apparently is regarded as merely a property tax in another form. The Supreme Court has upheld the constitutionality of a tax upon the net income of a domestic corporation, derived from transactions in interstate commerce, on the ground that such a tax does not constitute a direct burden upon interstate commerce.[33] What is the difference between the effect of taxes on gross receipts and that of taxes upon net income? A tax upon gross receipts affects every transaction whether profitable or not, and may even diminish the profits so as to impede or discourage commerce, whereas a tax upon net profits cannot have the same deterrent effect because it is not heavy unless the profits are large.

A tax upon the personal property of a corporation engaged in interstate commerce appears to be valid even though the property is used in such commerce. The property receives the protection

[29] Philadelphia and Reading Ry. Co. v. Pa. (1873) 15 Wall. 232, 21 L. Ed. 146.

[30] Philadelphia Steamship Co. v. Pa. (1887) 122 U. S. 326, 30 L. Ed. 1200, 7 S. Ct. 118; Galveston Ry. Co. v. Tex. (1908) 210 U. S. 217, 52 L. Ed. 1031, 28 S. Ct. 638.

[31] Me. v. Grand Trunk Ry. Co. (1891) 142 U. S. 217, 35 L. Ed. 994, 12 S. Ct. 121.

[32] U. S. Express Co. v. Minn. (1912) 223 U. S. 335, 56 L. Ed. 459, 32 S. Ct. 211.

[33] U. S. Glue Co. v. Town of Oak Creek (1918) 247 U. S. 321, 62 L. Ed. 1135, 38 S. Ct. 499.

of the state and should therefore bear its share of the tax burden.[34] Such a tax must not discriminate against or unduly burden interstate commerce.

There is no objection to a state tax upon motor vehicles engaged exclusively in interstate commerce. Such a tax is merely compensation for the use of the public highways, which have been erected and which are maintained by the state. However, the tax may not be excessive; it may be no more than a fair contribution to the cost of constructing and maintaining the highways.[35]

IV. Federal Control of Intrastate Commerce.

In conclusion, a few words should be said concerning the control of the Federal government over intrastate commerce. As a general rule, the regulation of intrastate commerce remains with the states. However, in a few instances, the courts have allowed the Federal government some authority, where it is necessary for an adequate and proper control of interstate commerce or where the interstate and intrastate commerce are inextricably commingled.

The control of the Interstate Commerce Commission over railway rates within a state affords a striking illustration of this point. In the Shreveport rate cases, this doctrine received its first important application. Rates from certain points in Texas to Shreveport, Louisiana, had been considerably higher than intrastate rates from the same points to other points in Texas.[36] The Interstate Commerce Commission issued an order pertaining to intrastate rates which removed this discrimination. The United States Supreme Court upheld the validity of the order upon the ground that the power of the Federal government over interstate commerce was complete and paramount and was adequate to meet exigencies and to curb such threats to interstate commerce as existed in this case. In the case of the *Railroad Commission of Wisconsin v. Chicago, Burlington and Quincy Railroad Company*, this principle was further extended.[37] The

[34] See "The Law of the American Constitution," p. 249, by Charles K. Burdick.

[35] Sprout v. City of South Bend (1928) 277 U. S. 163, 72 L. Ed. 833, 48 S. Ct. 502.

[36] Houston E. and W. Tex. Ry. Co. v. U. S. (1914) 234 U. S. 342, 58 L. Ed. 1341, 34 S. Ct. 833.

[37] (1922) 257 U. S. 563, 66 L. Ed. 371, 42 S. Ct. 232.

Interstate Commerce Commission allowed an increase in passenger fares to 3.6 cents per mile; whereas under state regulation, the railroads were forbidden to charge more than 2 cents per mile. The Supreme Court of the United States upheld the order of the commission even though it applied to intrastate passenger rates. To have allowed a continuance of the 2-cent rate for intrastate commerce would have seriously hampered interstate commerce since such commerce would have had to bear too great a proportion of railroad expenses.

The safety appliance laws afford another illustration of the power of the Federal government to control intrastate commerce.[38] These acts apply to all cars or locomotives on any railroad engaged in interstate commerce. It does not matter whether the cars or locomotives are used for interstate or intrastate traffic.[39]

Also, it has been held that the Interstate Commerce Commission has power to issue a *certificate of convenience and necessity* authorizing abandonment of both interstate and intrastate service of a railroad where the line which it seeks to abandon is part of a large interstate system.[40] To limit the commission's authority to interstate traffic might result in injury to interstate commerce. If the Interstate Commerce Commission ordered the abandonment of interstate traffic over a branch line which was operating at a loss, and a state commission could compel the continuance of intrastate traffic over the same line, the railroad would be compelled to take money from interstate traffic on other parts of its line to support the intrastate traffic.

In addition, the Interstate Commerce Commission has control over the issuance of securities by railroads, even though the money derived therefrom is to be used in part for interstate and in part for intrastate operations.[41] It would be very nearly impossible to separate interstate and intrastate commerce in case of control of security issues; that is, it would be very difficult

[38] U. S. Code, Title 45, Chap. 1, Secs. 1–43.

[39] So. Ry. Co. v. U. S. (1911) 222 U. S. 20, 56 L. Ed. 72, 32 S. Ct. 2.

[40] Colo. v. U. S. (1926) 271 U. S. 153, 70 L. Ed. 878, 46 S. Ct. 452.

[41] See the wording of the Interstate Commerce Act, U. S. Code, Title 49, Sec. 20 a (2) which says that it shall be unlawful for any carrier by railroad to issue *any* share of capital stock, etc., even though permitted by the authority creating the carrier corporation, without permission of the Interstate Commerce Commission.

to determine exactly what portion of the money received from the sale of stocks and bonds would be devoted to interstate and what part would be devoted to intrastate operations.

Although the regulation of the railroads furnishes most of the illustrations of the control of intrastate commerce by the Federal government, there are several other examples of Federal control of intrastate commerce. The Pure Food and Drug Act of 1906 stated that adulterated or misbranded foods or drugs which had been transported in interstate and foreign commerce and which remained unloaded, unsold, or in the original package might be proceeded against in a district court and seized for confiscation. Even though this was a regulation of intrastate commerce, the Supreme Court upheld its constitutionality.[42] The recently enacted Bituminous Coal Act of 1937 states that wherever the Bituminous Coal Commission finds that transactions in coal in intrastate commerce cause any discrimination against interstate commerce in coal, the commission shall so declare, and such sales shall be subject to certain provisions of the act.[43]

V. Federal Expansion under the Commerce Clause.

The necessity for additional Federal control of business is becoming increasingly obvious. More and more, state boundaries are ceasing to have any industrial and economic significance. State regulation at its best is becoming less and less able to cope with the large economic and industrial units which are resulting from centralization. Such power as Congress enjoys at present over business is derived almost exclusively from the commerce clause. When one realizes that the commerce clause was drafted and first interpreted in the light of an economic system existent at the beginning of the nineteenth century, one can see why the courts have had difficulty in stretching it to meet changed economic conditions. Inasmuch as political and legal changes lag behind economic, the wonder is that this clause with its interpretations has come as near to meeting modern requirements as it has. With the realization of the necessities for the expansion of Federal control over business and the legal barriers thereto, the question arises as to the constitutional possibilities of an extensive regulatory program.

[42] U. S. Code, Title 21, Sec. 14.

[43] Public Act No. 48, 75th Congress, 1st Session, Sec. 4-A.

Congress has by no means exhausted the possibilities of the commerce clause even under the present court interpretations. Many things which are undeniably interstate or foreign commerce have not been regulated. Furthermore, if the courts are willing to regard general movements of commodities throughout the United States as interstate commerce, as they have done recently, numerous opportunities for Federal regulation are open. Also, it must be remembered that Congress has the power *to prevent interference* with interstate and foreign commerce and that Congress has the power to regulate intrastate commerce where closely connected with interstate. The extension to their limits of these last two powers would greatly increase the breadth and extent of federal control.

Some new definitions of commerce by the courts could go a long way toward increasing the power of Congress. They could include many phases of business, such as insurance, agriculture, and mining, which are not now regarded as commerce by the courts.

State cooperation with the Federal government can achieve much toward the proper regulation of business. When Congress passes a law governing a certain phase of interstate and foreign commerce, if states will enact laws with similar provision covering intrastate commerce, constitutional difficulties will be largely eradicated. States have done this to some extent. For example, several states enacted statutes designed to supplement the National Industrial Recovery Act. Likewise, a number of states enacted legislation supplementing the Air Commerce Act of 1926.

A new commerce clause added to the Constitution by way of amendment and containing a much broader definition of commerce would offer great possibilities for expanding Federal control. It would enable Congress to make provision for the regulation of many kinds of business not now regarded as commerce. It could give to the central government more power to regulate intrastate commerce. However, if the courts are willing to interpret the commerce clause so as to permit Federal regulation to keep abreast of economic developments, they can obviate the need of an amendment to the Constitution.

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CHAPTER IV

METHODS OF CONTROL

If governmental authorities decide that a policy of *laissez faire* is not conducive to the best interests of society and that the state must by some means seek to control business, such control may take several forms. Some of these may be called "legal" methods, and others may be designated as "economic" methods of control.

In a "legal" method of control the government lays down rules of conduct which business must follow and then provides for the enforcement of these rules. In the United States both state and Federal governments have relied chiefly upon various "legal" methods of control.

In the case of an "economic" method of control the government, instead of laying down rules and regulations which business must follow, undertakes the ownership and operation of certain businesses. Sometimes the government maintains a monopoly, and sometimes it merely owns and operates enough of a business to furnish competition.

Another "economic" method of control is through the organization and operation of cooperative businesses by groups of consumers and producers. Such cooperatives furnish the competition which in turn automatically regulates private business. Obviously in the case of cooperatives, the government plays only a minor part; perhaps merely encouraging or facilitating the formation of cooperative societies which will furnish the competition necessary to regulate.

I. Direct Control through Statute.

Long before the modern development of administrative machinery, direct control of business existed. Under this method the legislature prescribes rules, and individuals or prosecuting attorneys sue in court for violation of these rules. Obviously this is a "legal" method of control.

One of the most familiar illustrations of the direct control of business has been that exercised over public callings. At common law, the courts without legislative assistance exercised some control over inns and common carriers. Occasionally, even in recent times, legislative bodies both state and municipal have imposed obligations and then trusted to litigation through the courts to enforce the obligations.

Sometimes legislatures have enacted detailed statutes fixing the obligations of public callings. Witness, for example, the regulatory effort of the legislature of West Virginia in fixing by statute a passenger fare of 2 cents a mile.[1] Similarly, on one occasion the legislature of North Dakota fixed maximum intrastate rates for the transportation of coal in carload lots.[2] At another time, the legislature of North Dakota required by law the operation of one passenger and one freight train per day over each railroad.[3] Detailed stytutory provisions undeniably have the advantage of certainty. That very certainty, however, gives them an element of inflexibility which causes difficulty in the event of changing prices or conditions. A fair rate or an adequate service on a certain date may not be fair or adeqµate five years later.

Sometimes legislatures in their attempts to regulate public utilities have enacted general statutes imposing upon utilities the obligation to give adequate service at reasonable rates and trusting to litigation through the courts to enforce these obligations. Occasionally, legislatures have given to courts the authority to issue certificates of convenience and necessity or to order the discontinuance of service after proper proceedings.[4]

Direct control of public utilities by legislatures and courts has not been a great success. For one thing, legislators and judges are usually not trained to deal with the many technical problems which such control raises. Nor do courts have the necessary staff of trained assistants upon whom they can rely. Furthermore, court procedure is slow and burdened with technicalities. Such delays help to nullify effective regulation. Besides, all too often, if a public utility has violated some duty or obligation, the initiative in bringing suit is left to the private parties who have been

[1] Acts of Wisconsin, 1907, Chap. 41, p. 226.

[2] Laws of North Dakota, 1907, Chap. 51.

[3] Compiled Statutes of North Dakota, Sec. 4789.

[4] Laws of New Mexico, Chap. 93, Sec. 2; Iowa Code, 1931, Sec. 8162.

injured. Thus, regulation depends upon litigation between a public utility and its patrons. The average consumer finds it cheaper and easier to allow a utility to violate its obligations rather than to resort to court procedure to obtain enforcement. Furthermore, the doctrine of separation of powers has proved to be a handicap. For example, if the courts find a rate objectionable for some reason or other, they cannot prescribe a new rate because that would be exercising a legislative function, and courts under this doctrine are purely judicial bodies.

Another illustration of this method of control is that of the regulation of monopoly and restraint of trade under the Sherman Antitrust Law. Congress has declared that monopolies and combinations in restraint of trade are illegal and then, instead of creating an administrative board to carry out the provisions of the law, it has left the enforcement to the attorney general, private litigants, and the courts.[5]

The administration of the Sherman Antitrust Law cannot be regarded as one of the triumphs of collectivism. Undoubtedly the failure cannot be attributed entirely to the machinery or method of control, for many factors have been at work tending to undermine the efficacy of the law. The method of control, however, has been blamed, and probably rightly so, for some of the difficulties. The problems which have arisen are to a great extent economic, but the courts have lost sight of this and endeavored to emphasize the legal aspects. That is, they have tried to apply legal concepts to economic phenomena. For example, one might reasonably suppose that one of the important considerations in determining whether or not a combination violates the Sherman Act would be the desirability of the combination from the point of view of our economic society. But the courts have tended to ignore this question, seeming to prefer to dwell upon whether or not there is an intent to violate the law. In criminal law intent undoubtedly plays an important part. It is important to know whether a person did or did not intend to kill his neighbor, but from the point of view of our economic society the intent or nonintent to monopolize or restrain trade seems to be of little or no consequence. Also, courts deal with a variety of suits. It is unreasonable to expect them to have all of the data and information requisite to an intelligent administra-

[5] U. S. Code, Title 15, Secs. 2, 3, 4, 15, and 26.

tion of a statute such as the Sherman Law. Furthermore, courts settle controversies but ordinarily cannot deal with problems before the stage of litigation has been reached. Adequate regulation demands continuous control.

Another illustration of direct control of business through legislation is the administration of bankrupt estates through the various district courts of the United States. Much of the actual work is performed by referees and trustees, but final authority rests with courts. Here again is a phase of control which has been subjected to severe criticism. Many of the difficulties, such as scandals which have arisen in the appointment of receivers or the ready discharge of bankrupt persons, are probably not flaws inherent in this method of control. However, the lack of uniformity in procedure which has aroused criticism is due to the numerous courts having jurisdiction over bankruptcy. Furthermore, in bankruptcy as in other cases of judicial control too much emphasis is placed upon private interests and not enough upon social interests. Such social interests as preventing the waste of assets and the ready escape through bankruptcy of unscrupulous debtors are too often ignored.

II. Control through Charter and Franchise.

Another "legal" method of control which has been frequently used is control through the grant of authority to operate or to do business. States and municipalities have granted to corporations charters and franchises authorizing them to engage in business or to exercise some privilege and in turn have prescribed certain courses of conduct which must be followed. Not infrequently state and municipal legislative bodies have sought to regulate utilities by placing rate provisions in their franchises. For example, the franchise granted to the New York Interborough Transportation Company provided for a five-cent fare.[6] Another franchise which was given to a street railway in Georgia required the operation of cars over certain lines at least as often as every 30 minutes.[7] Since charters and franchises are regarded as contracts, their provisions are enforceable by suits brought directly in court. Like detailed statutory provisions, which have

[6] See Gilchrist v. Interborough Rapid Transit Co. (1929) 279 U. S. 159, 73 L. Ed. 652, 49 S. Ct. 282.

[7] Macon Ry. and Light Co. v. Corbin (1923) 116 S. E. 305, 155 Ga. 1.

been previously mentioned, detailed provision in franchises or charters are objectionable because of inflexibility.

III. Control by Administrative Officers.

The increasing complexity of the problems of the control of business and the increase in the number of businesses or phases of businesses which have required control have made it very difficult for legislative bodies to control directly through legislation or through charters. Legislatures have sought to solve the difficulty by creating administrative agents and imposing upon them certain powers and duties of regulation. During the latter part of the nineteenth century, many states created railroad commissions. In 1887 Congress established the Interstate Commerce Commission for the regulation of the railroads. During the early part of the twentieth century the movement spread rapidly. The state legislatures turned their railroad commissions into public service commissions and created other regulatory boards or officers. Later, Congress established, among others, the Federal Trade Commission, the Federal Communications Commission, and the Federal Power Commission, and created many subdivisions of the various departments and endowed them with regulatory functions. Here again both Federal and state governments have made use of a "legal" method of control.

One of the outstanding features of the control of business by administrative agents has been the breakdown of the doctrine of the separation of powers. In fact, administrative regulation represents the doctrine of concentration of powers. These commissions and agents often perform legislative functions, judicial functions, and administrative functions. Sometimes these functions are so intermingled that it is difficult to determine where one begins and another ends. A commission will sometimes make use of all three in one proceeding.

In the exercise of legislative functions, or quasi-legislative functions as they are more correctly designated, commissions or administrative agents prescribe rules of conduct for future action. Sometimes these take the form of general rules and regulations and sometimes they take the form of orders of individual application.

The exercise of quasi-legislative functions has become increasingly important in the regulation of business. Legislatures have

set up general standards of conduct by statute and then have delegated to administrative agents the power to make rules or orders under these general standards. Such delegation of legislative power has much to recommend it, especially where conditions are rapidly changing. New conditions can readily be met by rules and regulations of commissions without resorting to statutory enactment.

One illustration of the exercise of quasi-legislative functions is to be found in the regulation of radio communication. In the Communications Act, Congress has given to the Federal Communications Commission the power to assign frequencies and to determine the power and the time during which stations may operate.[8] Under this authority, the commission has issued orders setting up a broadcast band, fixing and assigning power, frequencies, and time for the operation of stations.[9]

Another illustration is to be found in the regulation of aviation by the Civil Aeronautics Authority. The law gives to the Civil Aeronautics Authority the power to make air traffic rules.[10] Under the power thus given by Congress, the Authority has promulgated a series of general rules and regulations governing take-offs, landings, and the height at which planes must fly over cities and open country.[11]

Recent legislation of Congress has given the President much quasi-legislative power by authorizing him to make rules and regulations controlling various phases of business. He has already made considerable use of these powers.

The exercise of judicial functions, or quasi-judicial functions as they are more correctly designated, is an important phase of the control of business by administrative agents. In fact, in some instances it has tended to overshadow the other functions. The judicial function consists of handing down decisions according to law on the basis of facts which are found. Commissions and certain other branches of administration spend much of their time in exercising quasi-judicial functions. Sometimes the quasi-judicial functions are exercised in controversies between private

[8] U. S. Code, Title 47, Sec. 84.

[9] See General Order 87 of the Federal Radio Commission, Annual Report, 1930, p. 19.

[10] Public Act No. 706, 75th Congress, 3d Session, Sec. 601.

[11] See Civil Air Regulations, Secs. 60.00 to 60.93.

parties, as, for example, when the Interstate Commerce Commission decides a case between a shipper and a railroad in which discrimination is alleged. Sometimes commissions exercise their quasi-judicial functions in suits between the government and private parties. Such would be a proceeding brought in the name of the Federal Trade Commission before the Federal Trade Commission charging some person with an unfair method of competition.

In exercising their quasi-judicial functions, administrative bodies have in some respects followed and in others departed quite decidedly from court procedure. A brief consideration of procedure before the Interstate Commerce Commission will illustrate some of the differences and similarities.

A letter from a shipper complaining of a rate charged by a carrier is sufficient to institute what is known as an "informal case" before the Interstate Commerce Commission. Generally such a communication is referred to the carrier against whom the complaint has been made with a request for added facts. If it appears that the carrier is willing to accede to the demand or that the claim is without merit, the commission notifies the shipper.[12] This procedure by informal complaint affords an inexpensive and quick method of disposing of many controversies. Furthermore, the technical requirements which are often an important part of court procedure and which frequently tend to make form rather than content the important thing have no place in disposing of informal cases. A large number of petty controversies are settled informally each year in this way, thereby avoiding the necessity of resorting to further proceedings.

If a party desires to institute a formal case before the Interstate Commerce Commission, he may file a complaint which is sent to the carrier. The carrier then makes an answer.[13] A hearing before an examiner follows, at which evidence and arguments are presented. At the conclusion, the examiner submits to the commission his findings of fact, conclusions of law, and his recommendations. If the parties to the controversy so desire, they may request an oral argument before the commission or a subdivision thereof. They may also file a printed statement of

[12] See "Railroads" by H. B. Vanderblue and K. F. Burgess, p. 31.

[13] See U. S. Code, Title 43, Sec. 13; see also "Rules of Practice before the Interstate Commerce Commission," 1927, p. 5.

their exceptions to the report, together with supporting arguments. If an oral hearing has been requested, a date is set upon which the parties will be heard. If no oral argument has been scheduled, the commission merely hands down its decision.[14] If either party is dissatisfied with the order, a request may be made for a rehearing. There is no general provision for an appeal from an order of the Interstate Commerce Commission. However, if an order is not obeyed by a carrier, a suit to enforce the order may be brought in a Federal district court.[15] Also a party against whom an affirmative order has been issued may sue in a Federal court for an injunction against the order.[16]

Many tasks of commissions and administrative agents are in the nature of administrative functions. One phase of administration is the making of investigations. Some of these investigations are made preparatory to issuing orders or rules and regulations and some of them are for information requested by or to be used by other branches of government. If regulation of business is to be effective, governmental agents must have the power and equipment to gather information extensively and thoroughly in order that they may perform their tasks intelligently. In addition to furnishing information for use by government agents, such studies, if given sufficient publicity, may be valuable molders of public opinion. They may bring to light practices which are illegal, unethical, or unsocial and may, through unfavorable publicity, bring about the discontinuance of such practices.

Another phase of the administrative function is "law enforcement." Many governmental agents entrusted with the regulation of business have been endowed with certain duties of law enforcement. The Federal Trade Commission may institute proceedings against a person who is using an unfair method of competition. State public service commissions may commence proceedings against utilities for violation of duties and obligations.

To draw general conclusions as to the success or failure of the regulation of business by administrative bodies is difficult. Unfortunately, in many cases it has not been conducted under

[14] For a description of this procedure see "Railroads" by H. B. Vanderblue and K. F. Burgess, pp. 33–37.

[15] U. S. Code, Title 49, Sec. 16.

[16] 38 Stat. L., 219; see also "Railroads" by H. B. Vanderblue and K. F. Burgess, p. 51.

favorable conditions. Frequently legislatures have not endowed commissions with adequate powers. Furthermore, legislatures have been prone to wait until the necessity for control was very urgent before acting, with the result that damage has been done before commissions have been given preventive authority. Also, administrative authorities frequently have had neither the funds nor the man power to regulate adequately. Furthermore, the quasi-judicial functions have frequently tended to overshadow the legislative and administrative functions of administrative agents. This is especially true of state public service commissions, which have apparently regarded themselves primarily as quasi-judicial bodies. To some extent public service commissions have made investigations and commenced proceedings on their own initiative against utilities, but for the most part they have left the initiative to private parties, apparently preferring to sit as judges and decide between the claims of utilities and consumers. This attitude on the part of commissions has led to the creation in some states of the office of public counselor, whose task it is to represent the public in cases against utilities.[17]

One of the great weaknesses of the regulation of business by administrative authorities is judicial review by the courts. Theoretically, it is desirable that actions of administrative agents should be subject to review by courts in order to prevent abuse. However, the rule has probably been productive of as much harm as good. A hostile judiciary can and sometimes has wrecked the best efforts of administrative agents. The Interstate Commerce Commission during the early years of its existence had many difficulties because of the hostility of the courts.[18] In the case of the Federal Trade Commission, one is almost tempted to say that the courts have been guilty of judicial sabotage in their review of orders of this body. State regulation of utilities has been made extremely difficult because utilities have been able to seek shelter against undesired regulation not only in state courts but also in Federal courts, on the grounds that they have been deprived of their property without due process of law. This has caused great difficulty in rate cases. Federal district courts

[17] See, for example, Acts of the General Assembly of Indiana, 1933, Chap. 93, Sec. 4.

[18] See "Judicial Control of the Federal Trade Commission and the Interstate Commerce Commission" by Carl McFarland, p. 109.

have sometimes completely ignored the valuations of commissions in rate cases and proceeded to substitute their own valuations.[19]

IV. Regulation through Codes.

Another of the so-called "legal" methods of control is that of regulation of business through codes. Private groups formulate the legislation, either in the codes themselves or through the rules and regulations of code authorities established by the industries, and governmental agents place their stamp of approval thereon. The codes and even the regulations of code authorities may be and sometimes have been given the force of law. Here, then, are neither statutes nor rules and regulations of administrative authorities but acts of legislation of private groups sanctioned by governmental agents.

Under this method of control, private groups are often entrusted with the performance of certain administrative functions. Code authorities aid in enforcing the legislation, collect information, and receive reports.

The control of business through codes has certain advantages over other methods of regulation. In the first place, it is in part self-regulation. Much of the legislation is self-imposed and depends for its enforcement upon the cooperation of those regulated. Such legislation should be easier to enforce than regulation imposed entirely by outsiders. In the second place, code regulation is comprehensive in the number of undesirable practices which it seeks to eliminate. Legislation usually strikes at only one or two undesirable practices; an administrative agent issues orders to cease and desist from only a few practices. By means of a code, however, a whole series of practices may be outlawed. In the third place, code regulation is comprehensive in the number of persons whom it reaches. In the regulation by administrative bodies, the efforts are often directed at isolated individuals or corporations. To strike at one or even a dozen while scores of other persons are doing the same thing is almost a futile gesture.

Code regulation has certain weaknesses. For one thing, although self-regulation has elements of strength, it must be fortified at its weakest points by adequate governmental author-

[19] See "Report of the New York Commission on Revision of the Public Service Commission Law," pp. 154–155.

ity. If 95 persons abide by self-imposed rules but five do not, and the government exercises no coercion on the five, the regulation may break down because the 95 are forced in self-defense to follow the five. Furthermore, code regulation is primarily regulation in the interests of producers and only secondarily in the interests of consumers. This is inevitable in self-regulation since groups which are imposing rules naturally choose those which are in their own interests.[20]

The most spectacular illustration of the regulation of business through codes was that undertaken in 1933 under the National Industrial Recovery Act. More than 500 codes were adopted by trade associations and approved by the Federal government.[21] The Bituminous Coal Act of 1937 provides for a modified form of code control.[22] The rules of conduct adopted at the "trade practice conferences" sponsored by the Federal Trade Commission are another illustration of control of business through codes.[23]

V. Control through Government Aid to Business.

Another method of control which has been little used is control through government aid to business. The government in giving aid to business may, of course, make no attempt to regulate. Most of the information furnished to commerce and industry by the various bureaus at Washington is given without any effort to regulate the enterprises which are the recipients of the information. Even in giving subsidies and making loans, the Federal government has attached few conditions. Yet here is a potentially effective method of control. Essentially it is a "legal" method of regulation. These grants can easily be turned into contracts between the government and the businesses which are the recipients of governmental aid. Such agreements can be enforced like other contracts. Too often, city, state, and Federal governments in the United States have offered aid of various kinds and exacted nothing in return. If any business is the recipient of a special favor from the government, there is every

[20] See "Can Business Control Itself" by Edgar L. Heermance, p. 44.

[21] See, for example, "Code of Fair Competition for the Ice Industry," 1933, and "Code of Fair Competition for the Iron and Steel Industry," 1933.

[22] Public Act No. 48, 75th Congress, 1st Session, approved Apr. 26, 1937.

[23] Annual Report of the Federal Trade Commission, 1932, pp. 49–54.

justification for exacting in return a promise to observe some rule of conduct which will be in the interest of the public.

Although this method of control is essentially limited in its scope because of the limited number of businesses which are the direct recipients of government assistance, it should be very effective over those businesses which receive government aid. Self-interest should prove a good enforcing device. Businesses that will not comply with the rules need not be granted assistance. Or if they do not live up to their obligations, they can be deprived of their aid or they can be sued for breach of contract. This method of control has been employed with some degree of success in the relations between Federal and state governments. Federal grants-in-aid to the states have often had conditions attached. It is possible that the same device might prove an effective method by which the government could impose certain types of regulations upon businesses which were receiving aid through subsidies, loans, or government purchases.

VI. Control through Government Ownership.

Sometimes the only effective method of control is through government ownership and operation. If control by legislation or administrative machinery is not effective, it may be necessary for governmental units to own and operate certain business enterprises in order to achieve the necessary measure of regulation.

Obviously there are varying degrees and ways of regulation through government ownership and operation. Sometimes authorities have decided that government monopoly in a particular industry is the most desirable way of controlling that industry. Sometimes the government has not sought a monopoly but has merely established a competing business enterprise which can be used as a yardstick to measure the practices of a certain business and furnish whatever competition may be necessary in order to regulate. Again, the government may merely own a business without attempting to operate. For example, the government may purchase stock in certain corporations and thereby exercise control without actually operating the business enterprise. Although stock ownership has not been extensively adopted, it might prove an effective method of control which would retain certain of the advantages of private operation. Finally, governmental authorities may be able to exercise effective control by

owning only a vital part of a business. For example, in England, the government permits private companies to produce and to distribute electricity to consumers but the government owns and operates the intermediate step, namely, the transmission of electricity, thereby effectively controlling the entire industry. Government ownership and operation in this form might be used to control effectively many industries which seem difficult to regulate by other methods.

VII. Control through Cooperatives.

As has been previously stated, one of the so-called "economic" methods for the control of business is through the organization and operation of cooperative enterprises which can compete with private business. Both producers' and consumers' cooperatives have proved effective as methods of regulating prices and quality of goods and checking the abuses of monopolistic power. Consumers and producers through their own organizations provide the competition which in turn regulates private business. Here is a method of control in which government need play only a minor role, if any. In fact, too much governmental interference may be detrimental rather than beneficial.

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CHAPTER V

TYPES OF REGULATION

Regardless of the method of control by which a government seeks to regulate business, that is, whether directly by legislation, by administrative machinery, through cooperatives, by franchises or charters, through codes, or by government ownership and operation, there are many different types of regulation that a government may employ. Obviously, governmental authorities may use any of the methods of control in order to make effective a particular type of regulation.

The Federal and state governments have undertaken many types of regulation, among which the most important are: investigating businesses and requiring reports, controlling entry into business, regulating prices, regulating service and quality, preventing discrimination, controlling monopoly and restraint of trade, and preventing unfair methods of competition.

I. Investigations and Reports.

Investigations and reports have been used extensively by both Federal and state governments in seeking to control business. Sometimes this type of control is used as a preliminary to legislation; sometimes it is used as an aid to other types of control, as in the case of the regulation of public utilities; and sometimes it is undertaken and the results made public with the hope that the force of public opinion will compel business to desist from some course of conduct which is contrary to social interests.

II. Entry into Business.

Many instruments for controlling the entry into business have been used by Federal and state governments. The most common are licenses, franchises, and certificates of convenience and necessity.

Licensing has become very common in the United States. Vendors of liquor and cigarettes; persons who deal in certain

food products, such as milk; operators of restaurants, warehouses, trucks, taxicabs, poolrooms, hotels, theaters, and dance halls are frequently required to obtain licenses from state or municipal authorities.[1] Licenses are quite generally required before persons may engage in certain occupations, such as the practice of medicine, dentistry, and barbering. States usually require licenses of insurance companies, as well as licenses from their agents and brokers. Some of the states require licenses before persons may act as brokers or salesmen of stocks, bonds, and other securities. The Federal government issues licenses to persons erecting power plants and similar projects on the navigable waters. The Federal government also issues many kinds of licenses in its attempts to regulate aviation.

Sometimes licenses are issued chiefly for revenue purposes. Sometimes they are required merely as a device for registration, that is, as a kind of census to obtain information concerning the persons engaged in certain occupations. Sometimes licenses have been used chiefly as regulatory instruments.[2] Frequently, where so used, certain requirements must be met by those seeking a license, thus protecting the public against unqualified persons. For example, in many states licenses are granted only to insurance companies which meet certain requirements.[3] Licenses for doctors and dentists are granted only to persons who have fulfilled requirements and passed examinations.

Occasionally the licensing authority may attach conditions. The Federal Power Commission issues licenses subject to conditions mentioned by statute but may attach other conditions also.[4] Such power enables the licensing agent to fit the regulation to the individual case, thus providing a certain amount of flexibility.

Sometimes the license is used as an aid in enforcing laws. If the licensing agent has power to revoke the license, or to refuse to renew the license because of disobedience of the law, he has a powerful weapon for controlling business.

[1] See "Municipal Licensing Powers" by Thomas A Matthews, *Bulletin* 26, Illinois Municipal League, 1929.

[2] "The Law of Municipal Corporations" by Eugene McQuillan, Sec. 1091, Vol. 3, 2d ed.

[3] See Chap. XV, "State Control of Insurance."

[4] U. S. Code, Title 16, Sec. 803 g.

The discretion granted to the licensing authority either in issuing licenses or in revoking them varies tremendously. Some statutes set forth quite specifically the grounds upon which such licenses shall be granted or revoked, and some give considerable latitude for the exercise of discretion. Even though an administrative agent is allowed much discretion, tests or standards to guide him must be established by the legislative body in order to avoid the taint of unconstitutionality.[5]

Generally speaking, there are three types of franchises, the "franchise to be" by which a corporation comes into existence, the "franchise to do" by which a corporation is given the power to engage in a particular business, and the "franchise to use" by which some business, usually a public utility, is given the right to make some special use of the streets or alleys, such as laying water pipes or erecting telephone poles.[6] Franchises have been used quite extensively as regulatory devices. Inasmuch as corporate entities have only such powers as are conferred upon them by the state or its agent, it is possible for a government to exercise considerable control over them through granting some powers, withholding others, and imposing restrictions in their franchises.

The certificate of convenience and necessity, although not a new device, has been used frequently during the last two decades. Where used, persons may not engage in businesses or increase facilities until permission has been obtained from some governmental authority. Such authority is to grant the permission only if the public convenience and necessity require the proposed service or facility. In general, the purpose of requiring these certificates is to foster monopoly or quasi-monopoly, or at least to prevent overexpansion.

In some industries monopoly is advantageous not only to the industry but, if properly regulated, to the public also. This is especially true of certain kinds of public utilities. Two sets of telephone or electric poles, two street railway or telephone systems within the same city are an inconvenience to the public. An excessive number of busses and trucks increases the wear and tear on the highways as well as unnecessarily adding to the dangers of motorists.

[5] See note to the case in 167 At. 891, 32 *Michigan Law Review* 555.

[6] "Outlines of Public Utility Economics," by Martin G. Glaeser, p. 198.

In other industries, the certificate is advantageous to the industry as a protection against the disastrous consequences of cutthroat competition, thus enabling the industry to stabilize itself and balance somewhat supply and demand. The over-expanded cotton textile industry affords a good illustration of a business which has been much in need of protection against the installation of additional productive capacity. Also, the certificate can be used to protect industries against a certain kind of economic blackmail or piracy. For example, it has been asserted that the Nickel Plate Railroad was built not because it was needed, but to compel competitive lines to take over the system or suffer the disastrous consequences of ruinous competition.[7] Another case has been cited wherein a certain person threatened to build an ice plant in a community in which two large ice plants were already shut down twelve months out of the year, unless he was paid $25,000 a year by the operators of the established plants. As his proposition was not accepted, he erected a new plant.[8]

The certificate of convenience and necessity first made its appearance in 1892, when the legislature of New York required such certificates of persons who were planning to construct new railroads. The New York legislature followed by requiring them of street railways in 1895. Since these beginnings, their application has gradually been extended. The Transportation Act of 1920 gave to the Interstate Commerce Commission the power to permit extensions or new railroads upon a showing that public convenience and necessity required the proposed facility. Nearly all states require such certificates for passenger busses and many require them for motor trucks. Permits to erect and operate radio stations are granted by the Federal Communications Commission upon a showing that public interest, convenience, and necessity require the proposed facility. Although the Federal statutes make no definite requirement of certificates for organizers of national banks, the comptroller of currency has, for some time, required such persons to make a showing that convenience and necessity require the proposed banking facility. A recent statute of Indiana gives the banking department an opportunity to investigate and refuse an application where there is no public

[7] See p. 186, "The Robber Barons" by Mathew Josephson.

[8] See p. 53, *The U. S. News*, Supplement, March 16, 1934.

necessity for the financial institution in the locality where it is to be established. Oklahoma attempted to extend the application of certificates to other fields, but its efforts were checked by decisions of the United States Supreme Court. Some of the codes established under the National Industrial Recovery Act prohibited the installation of additional productive capacity without a certificate of convenience and necessity or its equivalent from the administrator.[9]

III. Prices and Rates.

Until the recent case of *Nebbia v. New York* was decided by the Supreme Court of the United States, it was generally assumed that price control was a type of control which could be exercised constitutionally only over businesses affected with a public interest.[10] In earlier cases, the Supreme Court had held that price regulation of the buying and selling of gasoline, the operation of private employment agencies, and the sale of theater tickets was a violation of the due process clause of the Fourteenth Amendment. In the Nebbia case, the Supreme Court permitted the State of New York to fix the retail price of milk, and used language which indicated a more liberal attitude toward attempts by states to fix prices.

Price control has been undertaken in several fields by both state and Federal governments. Sometimes they have provided for maximum price control, sometimes for minimum price control, and sometimes for both.

The fixing of maximum prices is of importance chiefly in protecting the public against abuses by industries which enjoy a monopoly. Occasionally, it has been employed to protect the public in times of shortage of an essential commodity or service. The regulation of rates of public utilities by state commissions furnishes an illustration of the attempt to set maximum rates.

The fixing of maximum charges entails certain difficulties. The continuous opposition of the parties regulated, aided and

[9] See the Codes of the Lace Industry, Excelsior Products Industry, Structural Clay Industry, American Glassware Industry, Ice Industry, Cotton Textile Industry, and Pyrotechnics Industry.

[10] Nebbia v. New York (1934) 291 U. S. 502, 78 L. Ed. 940, 54 S. Ct. 505.

abetted by the courts, has tended to defeat effective regulation of maximum prices or rates. Furthermore, no satisfactory formulas have been developed by which to determine the justice and reasonableness of rates. It is easy to repeat the formula that a public utility is entitled to a fair return upon the value of its property over and above operating expenses and a sum for depreciation. The difficulties of applying this simple formula are tremendous. A rate base must be selected and all of the items which are to be included must be determined. Besides, if such nebulous items as "going value" find their way into the rate base to any appreciable extent, or if exaggerated sums for depreciation are permitted, maximum rate regulation is little protection to the public.

Minimum price fixing is largely beneficial to the industry itself. The public may benefit indirectly through stabilization of the industry. Many instances of minimum price fixing are to be found. The Interstate Commerce Commission has had the power for many years to fix not only maximum but also minimum rates for railroads.[11] Recently, as mentioned above, a board in New York fixed minimum prices for the sale of milk at retail.[12] Some of the codes and regulations adopted under the National Industrial Recovery Act sought control of minimum prices.[13]

The difficulties of minimum price control are tremendous. For one thing, the problem of enforcement causes difficulty. The necessity for minimum price control usually arises in a highly competitive industry. As a result of the great number of units, the task of policing is difficult. For another thing, the problem of determining a just minimum price is not easy. However, those who argue against government price fixing should not forget that if the government does not intervene, price fixing is quite likely to be undertaken clandestinely by various groups who find intolerable the anarchy resulting from cutthroat competition and who can sufficiently organize their members to bring about an agreement. The pools and other types of combinations which have appeared from time to time in the railroad, oil, and steel industries bear out this assertion. Of course, in many industries, especially

[11] U. S. Code, Title 49, Sec. 15 (1).

[12] See case of Nebbia v. New York referred to in footnote 10.

[13] "Code of Fair Competition for the Retail Trade," Art. VIII, Sec. 1; also, p. 145, *N. R. A. Reporter*, April 15, 1934.

those made up of small units, cooperation is impossible without governmental aid and sanction.

IV. Service and Quality.

Federal and state governments have not made many attempts to regulate service and the quality of goods. The statutes governing public utilities usually provide that the service which they render shall be safe and adequate and often provide that utilities shall not discontinue service without the consent of some agent of the state. Under such statutory provisions, public service commissions have frequently prescribed standards of service for gas, electric, water, and motor-transportation companies.[14] The efforts to prevent the sale of dangerous or fraudulent foods and drugs or the sale of fraudulent stocks and bonds afford other illustrations of the regulation of the quality of goods which are sold to the public.[15] To a certain extent the licensing of insurance companies, doctors, dentists, and some others is an attempt to assure the public that those who furnish these services are properly qualified companies or individuals.

V. Discrimination.

The prevention of discrimination is somewhat related to the problem of monopoly and restraint of trade. Certain industries which are in an advantageous position may by discrimination ruin one business and materially contribute to the prosperity of a competitor. The most elaborate attempts to prevent discrimination are to be found in the statutes regulating railroads. The Interstate Commerce Act strikes at all kinds of preferences, not only those between persons, but also those between localities and those between kinds of traffic.[16] Various provisions against discrimination are to be found in the statutes controlling public utilities. The Packers and Stockyards Act prohibits discrimination in rates and services on the part of persons furnishing facilities at the stockyards.[17] The Clayton Antitrust Law makes it

[14] See Chap. XII, "Public Utility Regulation" by W. E. Mosher and F. G. Crawford.

[15] See Chaps. XX and XXI.

[16] U. S. Code, Title 49, Secs. 2, 3, 4.

[17] U. S. Code, Title 7, Secs. 206 and 208.

unlawful for the seller to discriminate in price between different purchasers of the same kinds of commodities where the effect is to lessen substantially competition.[18] A statute of Montana states that it is unlawful for a person with the purpose of creating a monopoly or destroying an established business to discriminate between persons or communities by purchasing a commodity at a higher price in one section than in another after making allowance for transportation costs and differences in quality.[19]

VI. Monopoly and Restraint of Trade.

The regulations of monopoly and restraint of trade have sometimes taken the form of sweeping condemnations of all tendencies toward concentration, as in the case of the Sherman Antitrust Law. Such broad terminology as that employed in the Sherman Act has the disadvantage of being vague and indefinite. Besides, it has seemed to be in direct contravention to the apparently inevitable trend toward economic centralization in the United States. As a result, judicial and legislative bodies have gradually modified its sweeping provisions.

Sometimes the regulations of monopoly and restraint of trade have taken the form of prohibitions of specific practices which have the tendency to restrain trade or create a monopoly. Thus, under the Clayton Antitrust Law, interlocking directorates, stock ownership by one corporation of another, exclusive dealing agreements in selling or leasing goods, and price discriminations have been made unlawful.

Sometimes the Federal or state legislatures instead of making monopoly or restraint of trade unlawful have given to governmental agents the power to approve or reject combinations. For example, the public utility acts of many states give to utilities the power to sell their property, to merge, consolidate, or acquire the stock of one another on approval of the public service commission.[20] Also, the Interstate Commerce Commission has been given the power to approve railroad combinations or consolidations which are in the interests of the public.[21]

[18] U. S. Code, Title 15, Sec. 13.

[19] Laws of Montana, 1925, Chap. 131, Sec. 1.

[20] See "State Control of the Consolidation of Public Utilities" by Ford P. Hall, 81 *Pennsylvania Law Review* 8.

[21] U. S. Code, Title 49, Sec. 5, as amended.

VII. Unfair Methods of Competition.

Closely allied to the control of monopoly and restraint of trade is the prevention of unfair methods of competition. The Federal government has made two distinct attempts to stamp out unfair methods of competition, the first by the Federal Trade Commission Act of 1914, and the second through the use of codes under the National Industrial Recovery Act of 1933.

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CHAPTER VI

REGULATION OF RAILROADS

The most extensive program of regulation which the Federal and state governments have undertaken is that pertaining to the railroads. From their entry into service until their abandonment, carriers by rail are subject to governmental control. The government prohibits the construction of railroads without its consent, requires adequate service at reasonable rates, polices accounts, controls consolidation and the issuance of securities, seeks to prevent discrimination, forbids the discontinuance of service without the consent of the proper authorities, and even aids in the settlement of disputes between railroad employers and employees.

All of the above-mentioned phases of regulation represent attempts to remedy prevalent abuses which arose under a system of *laissez faire*. The middle and latter part of the nineteenth century and to some extent the early part of the twentieth century were periods of frenzied railroad development. Railroad expansion was rapid and too often accompanied by great abuses and scandals. Irresponsible financial manipulation, overcapitalization, rebating and unfair discrimination, and unregulated monopoly with its attendant evils brought the inevitable public reaction.[1]

About 1870 the states began to act. Some of them created commissions whose powers were limited to the conduct of investigations and issuance of reports, relying largely upon public opinion to enforce their orders.[2] But state legislation even at its best could not be effective. Railroads were no longer mere intrastate carriers but were rapidly extending their lines and becoming interstate in character. The effort of the states to

[1] "The Interstate Commerce Commission" by I. L. Sharfman, Vol. I, p. 17.

[2] "The Interstate Commerce Commission" by I. L. Sharfman, Vol. I, p. 15.

control railroads was given a decided blow by a decision of the Supreme Court holding that the control of interstate commerce was largely a function of the Federal government.[3] Congress met this challenge by passing the Interstate Commerce Act of 1887. The Act of 1887 was followed by numerous amendments and ancillary acts, chief among which were the Hepburn Act of 1906 and the Transportation Act of 1920.

Even after 1887, states enacted railroad legislation. Since that time, however, the Federal government has tended to push the states into the background and to occupy more and more the field of railroad control. Despite this tendency the states have retained a measure of control over railroads, so that even today we find that railroads are regulated in part by the Interstate Commerce Commission and in part by the railroad or public service commissions of the various states.

The line between state and Federal control is not well defined, however. It does not follow even the somewhat obscure division between interstate and intrastate commerce. On the one hand, the courts have allowed the Federal authorities to exercise some control over intrastate commerce. On the other hand, they have permitted states, in the absence of Federal regulation, to control interstate commerce to some extent. The result is uncertainty, which, in turn, is productive of much litigation and attempted evasion of regulation.

The subject of railroad regulation divides itself logically into several large classes, of which the following are the most important: service, consolidation, security issues, rates, reorganization, and discrimination.

I. Service.

In the regulation of the service of railroads, state commissions and other state authorities still play an important part. This is true not only of intrastate service, but also that which is interstate in character. Congress has failed to regulate certain phases of interstate commerce, thus leaving these areas open for a measure of state control.

Generally speaking, the subject of service regulation can be divided as follows: extensions and new railroads, car service,

[3] Wabash St. Louis and Pac. Ry. v. Ill. (1886) 118 U. S. 557, 30 L. Ed. 244.

terminal facilities, spur and side tracks, and abandonment of service.

1. *Extensions and New Railroads.* The early period of railroad development was marked by cutthroat competition and extensive building. Neither Federal nor state governments attempted to curb railroad activities. The result was an overexpansion and needless duplication of facilities, a situation from which many of the carriers have never fully recovered. In 1892 the State of New York took the initiative in curbing railroad activity by enacting a law which required persons planning the construction of new railroads to obtain from a governmental agent what is now commonly referred to as a certificate of convenience and necessity.[4] Other states have followed the lead of New York by enacting similar legislation. As might be expected, such state legislation has varied considerably, but in general requires railroads to show that there is public need for the line which they are proposing to construct.[5]

During the first two decades of the twentieth century, the Federal government had no such legislation, but in 1920 the Transportation Act amended the Interstate Commerce Act as follows:

> No carrier by railroad subject to this chapter shall undertake the extension of its line of railroad, or the construction of a new line of railroad, or shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation under this chapter . . . unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation . . . of such additional or extended line of railroad . . . [6]

This paragraph of the Interstate Commerce Act gives to the commission a very considerable control over railroad activity. No new railroad can commence construction or operation without the commission's consent. Nor can a railroad install a branch line, make an extension of an existing line of road, or acquire and operate the lines of another railroad without a certificate. The act has been interpreted as going so far as to require a carrier by

[4] Laws of 1892, Chap. 676, Sec. 59.

[5] For a list of the states having legislation of this kind, see "Certificates of Convenience and Necessity" by Ford P. Hall, 28 *Michigan Law Review* 107 (121).

[6] U. S. Code, Title 49, Sec. 1 (18).

rail to secure permission before relocating its line, before erecting terminal facilities, or even before resuming operation after discontinuance.[7]

Broad as is the control over new operations and facilities, it is subject to many limitations. Obviously, if a railroad operates solely in intrastate commerce, the commission has no jurisdiction.[8] Under the specific provisions of the Interstate Commerce Act, there is no necessity to get consent for the installation and operation of spurs and sidetracks lying wholly within a state. Street and interurban electric railways are also explicitly exempted from this requirement of securing a certificate from the commission.[9]

At least two reasons may be advanced for forbidding railroads to commence operation of new enterprises without securing consent from some governmental authority. In the first place, such a prohibition is a method of controlling competition. More and more, in the field of public utilities, the principle is developing that cutthroat competition is undesirable and that well-regulated monopoly better serves the needs of utilities as well as the needs of the public. Here is a method of preventing needless and wasteful duplication of facilities. In the second place, such a prohibition is a means of preventing the building of lines, the chief purpose of which is to make money for certain persons from the constructing and financing of the enterprises. Thus legislation requiring certificates of convenience and necessity can afford protection both to the public and to the carrier.[10]

In determining whether to grant or refuse an application, the important question is whether the convenience and necessity of the public require the proposed facility. The expression, convenience and necessity, is very vague and is not readily reducible to more exact terminology. As generally interpreted, it does not

[7] *In re* Crystal and San Juan R. Co. (1922) 72 I. C. C. 561; *In re* I. C. and St. L. Ry. Co. (1922) 71 I. C. C. 668.

[8] Texas and N. O. R. Co. v. Northside Belt R. Co. (1928) 276 U. S. 475, 72 L. Ed. 661, 48 S. Ct. 361; Bank of California, Nat'l. Ass'n. v. Clear Lake Lumber Co. (1928) 264 Pac. 705, 146 Wash. 543.

[9] U. S. Code, Title 49, Sec. 1 (22).

[10] For a discussion of certificates of convenience and necessity see the articles, "Public Encouragement of Monopoly in the Utility Industries" by Charles S. Hyneman, *Annals of the American Academy of Political and Social Science*, January, 1930, p. 160; "Certificates of Convenience and Necessity" by Ford P. Hall, 28 *Michigan Law Review* 107.

mean absolute necessity and it does not mean mere convenience. The two words are inextricably linked, and something between the extremes must be proved before an applicant is entitled to a certificate.

The question which most frequently arises in petitions of this sort is whether or not to grant a request when there already exists in the territory a competing carrier. If the service is adequate and the territory well covered, public convenience and necessity do not demand an extension or a new line. Following this rule, the Interstate Commerce Commission refused an application when it found that 60 per cent of the tonnage expected on a proposed new route would be diverted from existing carriers.[11]

The problem of preventing unnecessary competition is not the sole question which arises in determining whether or not public convenience and necessity requires an extension of railway facilities. Sometimes the commission will refuse to issue a certificate to a railroad seeking to make an extension into unoccupied territory when there is serious doubt as to the probable financial success of the enterprise.[12] Public convenience and necessity cannot be said to require a line when there is likelihood that its operation will result in a great financial loss. However, the commission sometimes grants a certificate for a new line which probably will not immediately pay if the future convenience and necessity of the public justifies such action.

Thus far, mention has been made only of the power to *refuse* or *grant* applications to make extensions, but several state commissions and the Interstate Commerce Commission have been given the power to *require* a railroad to build extensions if the needs of the public demand it.[13] Provisions of this sort appear to be just one more statutory recognition of the principle that railroads are not primarily private enterprises but rather public businesses out of which a profit can be made. Therefore, if they fail in their duties, the government through the proper agency should compel fulfillment. By a somewhat narrow construction, the courts have restricted the regulatory authority of the commissions under these provisions. One typical case will illustrate the general attitude of the courts. The Interstate Commerce Commission

[11] *In re* Wichita Northwestern Ry. Co. (1922) 71 I. C. C. 42.
[12] *In re* Mich. No. R. Co. (1920) 65 I. C. C. 480.
[13] U. S. Code, Title 49, Sec. 1 (21).

ordered certain railways to build an extension of 180 miles through the State of Oregon. The Supreme Court held that the commission had exceeded its authority because the order contemplated the building of a *new* line of railroad, and pointed out that the authority of the commission was confined to compelling carriers to extend their lines within the territory which they had professed to serve.[14]

2. *Car and Train Service.* The question of the number of trains which shall be operated each day, the type of cars or similar equipment which shall be furnished to shippers must be decided in the first instance by the railroad management. However, state and Federal laws impose upon the carriers certain obligations and invest regulatory authorities with a measure of control over such service.

The Interstate Commerce Act states that railroads are under the obligation to furnish safe and adequate car service. In order to enforce this duty, Congress has given to the Interstate Commerce Commission the authority to make rules and regulations with respect to car service, to require railroads to file their rules and regulations, and to require these carriers to provide themselves with safe and adequate car service and facilities.[15]

The commission has declared that railroads need not own all of their rolling stock but that they may lease from other companies some of the more unusual kinds of cars.[16] Private ownership of tank cars, refrigerator cars, and coal cars is not uncommon. The commission has found that the ownership of such equipment by other companies is often desirable and advantageous to shippers as well as to carriers. This is especially true of tank cars, of which there are many varieties, some of them seldom in demand. To require each railroad to furnish itself with every type of tank car would cause a heavy and needless financial outlay.

The control of state commissions over *freight* service is very limited. Although many states have legislation dealing with such service, any such legislation which conflicts with Federal regulations must yield to the paramount authority of the United States to control interstate commerce. For example, a statute

[14] I. C. C. v. Oregon-Wash. R. and Nav. Co. (1933) 288 U. S. 14, 77 L. Ed. 588, 53 S. Ct. 266.

[15] U. S. Code, Title 49, Sec. 1 (10) (11) (13) (14) (21).

[16] *In re* Private Cars (1918) 50 I. C. C. 652.

of North Dakota which required the operation of one freight train per day was not allowed to stand in the way of a decision of the Interstate Commerce Commission declaring that triweekly service would suffice.[17]

The Interstate Commerce Commission is endowed with certain emergency powers with regard to freight service. In case of shortage of equipment, congestion of traffic, or other emergency it may suspend all rules and regulations and make such directions as will best promote the interests of the public.[18]

Over passenger service, even over that which is interstate, the states may exercise some control so long as there is no unreasonable interference with interstate commerce.[19] The Interstate Commerce Commission has decided that Congress has not invested it with authority to regulate passenger service. According to the commission, the term "car service" as defined in the Interstate Commerce Act expressly includes only the movement of cars used in the transportation of *property*.[20]

3. *Terminals*. The control of terminal facilities rests in part with Federal authorities and in part with the states. The Interstate Commerce Act requires every common carrier engaged in the transportation of passengers or property to afford all *reasonable* and *equal* facilities for the interchange of traffic and for the receiving, forwarding, and delivering of passengers and property to and from its lines.[21] Prior to 1920 the Interstate Commerce Commission had no power to require the joint use of terminals except to remove discrimination. If a railroad maintained what was called a *closed terminal*, that is, it did not permit the use of its terminal to any other carrier, the commission could not compel it to afford such facilities to other railways since there was no question of discrimination. If, on the other hand, the carrier maintained an *open terminal*, that is, permitted any other carrier to use the terminal, the commission could require it to afford the use of this property to other carriers where necessary

[17] *In re* Train Service on the Northern Pacific (1926) 112 I. C. C. 191.

[18] U. S. Code, Title 49, Sec. 1(15).

[19] See p. 6, "Public Utility Service and Discrimination" by Ellsworth Nichols.

[20] Railroad Com. of Wis. v. Chi. and N. W. Ry. Co. (1924) 87 I. C. C. 195; See also p. 76, "Railroad Regulation since 1920" by D. P. Locklin.

[21] U. S. Code, Title 49, Sec. 3(3).

to remove discrimination.[22] The Transportation Act of 1920 gave to the commission the power to require one carrier to afford the use of its terminal facilities to another if the commission found that it was in the public interest, was practicable, and did not substantially impair the ability of the carrier owning the terminal property to handle its own business.[23]

Before the commission will exercise its power to compel the joint use of terminals, a showing must be made that such unification will be in the interests of the public. To the commission the term "public interest" includes not only the interest of shippers located near the terminals involved but also the interest of the carriers and the interest of the general public. Basing a decision upon this conception of public interest, the Interstate Commerce Commission refused to require the Pennsylvania Railroad to afford the use of its facilities at a certain point to the Western Maryland because such an order would have been equivalent to requiring a division of traffic naturally tributary to the former road. This probably would have resulted in a loss to the Pennsylvania and a considerable gain to its competitor, the Western Maryland.[24]

Although the Transportation Act of 1920 has enlarged considerably the commission's authority over terminal facilities, the courts have held that the act does not give the commission the power to compel railroads to erect a union passenger station. An application was filed asking the commission to require the railroads serving the city of Los Angeles to erect a union terminal, but the commission decided that it had no such power and the Supreme Court of the United States upheld its ruling.[25] The court could find no express statement in the statute and refused to imply such authority, declaring that if Congress had intended to

[22] For a discussion of this see "Railroads" by Vanderblue and Burgess, p. 277.

[23] U. S. Code, Title 49, Sec. 3 (4).

[24] York Mfg. Ass'n v. Penn. R. Co. (1922) 73 I. C. C. 40.

[25] City of L. A. v. L. A. and Salt Lake R. Co. (1925) 100 I. C. C. 421. The commission declared that it had not been given the authority under Sec. 5 (4) of the Interstate Commerce Act. There was no question of discrimination under Sec. 3 (3) of the act. Sec. 1 (21) did not give this power where the station would be the principal thing and the extensions of the lines a mere incident. This decision was upheld in I. C. C. v. U. S. *ex rel.* Los Angeles (1929) 280 U. S. 52, 74 L. Ed. 163, 50 S. Ct. 53.

give this control to the commission, it would have explicitly so provided. However, in a subsequent case the Supreme Court upheld the validity of an order of the Railroad Commission of California requiring certain carriers to construct a union station in the city of Los Angeles.[26]

4. *Spurs and Sidetracks.* The Federal government has left the control of spurs and sidetracks largely to the states. Congress has inserted a provision in the Interstate Commerce Act which declares that the authority of the Interstate Commerce Commission shall not extend to the construction or abandonment of spurs or sidetracks located wholly within one state.[27]

State control of spurs and sidetracks has taken many forms. Some statutes require permission from a commission before sidetracks may be erected or abandoned. Other statutes give a commission the power to require railroads to build such tracks where reasonably necessary. In general, the constitutionality of giving such powers to commissions has been upheld. It should be noted, however, that the authority of the state cannot extend constitutionally to so-called private sidings.[28] Apparently, however, states may require switch connections to private sidings without violating any constitutional rights.[29]

5. *Abandonment.* In recent years the problem of discontinuance of service by railways has become one of considerable importance. In the first place, numerous unnecessary lines of road were built when competition was at its height. Many of these the railroads have sought to abandon without much consideration for public interest. Then the increase in motor transportation of freight and passengers has accelerated the demands of railroads to abandon service. The Interstate Commerce Commission and many state commissions have been made guardians of public interest and have been given the authority to approve or reject proposed abandonment of service by railroads.[30]

[26] A. T. and S. F. Ry. Co. v. R. Com. (1931) 283 U. S. 380, 75 L. Ed. 1128, 51 S. Ct. 553.

[27] U. S. Code, Title 49, Sec. 1 (22).

[28] "Public Utility Service and Discrimination" by Ellsworth Nichols, p. 69.

[29] "Public Utility Service and Discrimination" by Ellsworth Nichols, p. 70.

[30] U. S. Code, Title 49, Sec. 1 (18); For a list of some of the state statutes see "Discontinuance of Service by Public Utilities" by Ford P. Hall, 13 *Minnesota Law Review* 325.

The control usually extends both to total abandonment and to partial abandonment of a railroad. The extent of the control in each case is different. Total abandonment usually presents a constitutional question. If a carrier is operating its entire system at a loss, it has a constitutional right to discontinue in spite of an order of a commission to the contrary.[31] To hold otherwise would be tantamount to taking private property for public use without just compensation, thus violating the Fifth or Fourteenth Amendments of the United States Constitution. Even though a commission may not be able to order the continuance of a road which is losing money upon its entire system, it can prevent a total withdrawal which is made in so arbitrary a way that the public is not given an opportunity to adjust itself to the change.

Over partial abandonment, that is, abandonment of particular lines or parts of a railroad system, the authority of commissions may be more comprehensive. A railroad has no constitutional right to abandon a portion of its system merely because that part does not happen to be profitable.[32] So far as the public is concerned, a railroad system is operated as a unit and not as a series of separate entities. Its obligations and rights flow to and from the road as a whole and not to and from its parts. Furthermore, because of its public nature, a railroad should not be allowed to pick and choose, and to retain the profitable and discard the unprofitable. Even though a carrier may not have a constitutional right to discontinue a part of its system which is being operated at a loss, the fact that such part is unprofitable is a very cogent reason for permitting abandonment. Such a financial situation must be weighed against the public convenience and necessity and if the latter is sufficient to justify continuance, the petition for withdrawal will be refused.

As a general rule, the authority of the Interstate Commerce Commission does not extend to intrastate operations. Therefore, one would expect that if a railroad were both an interstate and intrastate carrier, the consent of the proper state authorities

[31] Brooks Scanlon Lumber Co. v. Ry. Com. of La. (1920) 251 U. S. 396, 40 S. Ct. 183, 64 L. Ed. 323; Tex. v. E. Tex. R. Co. (1924) 264 U. S. 79, 68 L. Ed. 659, 44 S. Ct. 247.

[32] For a discussion of this question see the articles, "The Withdrawal from Service of the Public Utility Companies" by Oliver P. Field, 35 *Yale Law Journal* 169; "Discontinuance of Service by Public Utilities" by Ford P. Hall, 13 *Minnesota Law Review* 325.

would have to be secured before intrastate operations could be discontinued. This is the rule where the railroad seeking withdrawal is an independent line lying wholly within a state and is no part of a larger interstate system.[33] However, if the line which the carrier seeks to abandon is part of a large interstate system, the Supreme Court has held that the Interstate Commerce Commission can authorize the abandonment of intrastate as well as interstate service.[34] To compel a carrier to perform intrastate service under such circumstances would drain its resources and would render it less capable of performing efficiently its interstate duties. Here is an instance in which the Federal government has the power to control intrastate commerce because of its intimate relationship with interstate.

The Interstate Commerce Act specifically declares that the authority of the commission to control abandonment does not extend to spurs or side tracks lying wholly within one state nor to street or interurban electric railways.[35] In the case of *Lucking v. Detroit and Cleveland Navigation Company*, the United States Supreme Court added another limitation upon the commission's power when it held that a steamship company, although engaged in interstate commerce, could discontinue service without securing Federal permission.[36] The court pointed out in this case that the Interstate Commerce Act did not include navigation companies since the provision pertaining to abandonment specifically mentioned only carries by railroad.

II. Consolidation and Other Forms of Combination.

One of the problems which is receiving much attention from persons interested in carriers is that of railroad combination. The problem is essentially national in character. Gigantic railroad systems such as those which are contemplated under the various schemes for unification are interstate in character and should be controlled by some body which can regulate their growth as entities and not by state commissions which, because of limited jurisdiction, can control only parts. To encourage or

[33] Tex. v. E. Tex. R. Co. (1922) 258 U. S. 204, 66 L. Ed. 566, 42 S. Ct. 281.

[34] Colorado v. U. S. (1926) 271 U. S. 153, 70 L. Ed. 878, 46 S. Ct. 452.

[35] U. S. Code, Title 49, Sec. 1 (22).

[36] Lucking v. Det. and Clev. Nav. Co. (1924) 265 U. S. 346, 68 L. Ed. 1047, 44 S. Ct. 504.

even allow combinations to arise under state authority is to invite confusion, evasion, and irresponsibility and to encourage practices that are inimical to the public welfare. Some of the corporate monstrosities which have appeared among the state-controlled electric utility industry should stand as warnings against too much diversity of control.[37]

A complete reversal in attitude toward the combination of carriers has taken place during a period of 30 years. In the early part of the twentieth century not only was railroad combination frowned upon but it was likely to be declared illegal. In the famous Northern Securities case the Supreme Court held that a union of the Great Northern and Northern Pacific was a violation of the Sherman Antitrust Law.[38] Less than 20 years later, one finds Congress not only removing the barriers, but actually making provision for fostering combination and even discussing the possibilities of compulsory consolidation.

The Transportation Act of 1920 as amended in 1933 has added to the Interstate Commerce Act a number of important provisions designed to legalize railroad combinations so that now the act embraces all of the important methods by which railroads seek to unite. The act covers pooling, purchases of property, stock acquisitions, leases, operating contracts, consolidations, and mergers.

Carriers may not enter into contracts for the *pooling* of freight or for dividing proceeds between different and competing railroads without the express approval of the Interstate Commerce Commission. The grounds upon which such approval may be given are specifically set forth in the act. The commission may approve if such an arrangement is in the interest of better service to the public, is for economy of operation, and will not unduly restrain competition.[39]

Another important provision of the Interstate Commerce Act orders the commission to draw up a plan for railroad consolidation in accordance with certain principles enunciated by the statute. Competition is to be preserved, existing routes are to be main-

[37] See the report of the Federal Trade Commission on Public Utilities, 70th Congress, 1st Session, Document 92.

[38] Northern Securities Co. v. U. S. (1904) 193 U. S. 197, 48 L. Ed. 679, 24 S. Ct. 436.

[39] U. S. Code, Title 49, Sec. 5 (1).

tained insofar as possible, and the systems are to be arranged so that the cost of transportation between competitors as related to the value of their properties will be the same insofar as practicable in order that uniform rates may be maintained.[40]

Acting under this paragraph, which was added to the act in 1920, the Interstate Commerce Commission proceeded to prepare a scheme and in 1921 published a tentative report providing for the consolidation of the railroads into 19 large systems.[41] After years of deliberation, the commission announced its final plan for railroad consolidation. Later this was modified at the request of the large eastern railroads. According to this scheme the railroads of the United States have been grouped into 18 systems. In each case, the commission has used one or two large railroads around which to build a proposed system. In New England, the *Boston and Maine* and the *New York New Haven and Hartford* form the nuclei of two groups of lines. The *New York Central*, the *Pennsylvania*, the *Baltimore and Ohio*, and the *Nickel Plate–Chesapeake and Ohio* have been made the boses for four large eastern systems. Two large southern ones are built around the *Atlantic Coast Line* and the *Southern*. Farther west, the *Illinois Central* and the *Chicago Northwestern* form the backbone of two large groups covering the central part of the United States. The *Milwaukee* and a combination of the *Northern Pacific and the Great Northern* lines form two competing systems stretching across the Northwest. The *Union Pacific*, the *Santa Fé*, the *Southern Pacific*, and the *Missouri Pacific* constitute the four great routes which are supposed to serve the central western and southwestern sections of the United States. The *Burlington* and the *Rock Island–Frisco* systems complete the list. Certain lines, such as the American subsidiaries of the two great Canadian systems (the *Canadian Pacific* and the *Canadian National*), the *Delaware and Hudson*, the *Seaboard Airline*, and a few others are not assigned to any one of the 18 groups.[42]

The Interstate Commerce Act also provides that with the consent of the Interstate Commerce Commission carriers may

[40] U. S. Code, Title 49, Sec. 5 (2).

[41] *In re* Consolidation of the Railroads (1921) 63 I. C. C. 455.

[42] *In re* Consolidation of the Railroads (1929) 159 I. C. C. 522. For the later changes made in this order see *In re* Consolidation of the Railroads (1932) 185 I. C. C. 403.

lawfully consolidate, merge, purchase, lease, or contract to operate their properties, or acquire control through the purchase of stock. Companies which are not carriers may also acquire control of railroads through the ownership of stock by obtaining the consent of the commission. If the commission finds that the proposed combination will promote the public interest and be in harmony with its scheme for consolidation, an order may be entered approving the plan.[43]

Railroad consolidation presents many intricate and knotty problems and calls for the adjustment of innumerable conflicting interests. There is the problem of making systems somewhat equal financially so as to provide for competition upon equal terms. There is the problem of the conflict between the existing ownership and relationship of lines with the proposed schemes of the commission. Also, the programs and ambitions of various carriers for expansion have not been and are not always in accordance with public interest. It has been no easy task to reconcile the many conflicts which have presented themselves. For example, the tentative consolidation plan of the Interstate Commerce Commission provided that the Milwaukee and the Great Northern were to form a system which was to compete with the Northern Pacific. This would have made two systems of somewhat equal strength which probably would have been able to compete upon equal terms. The difficulty with this arrangement lay in the close relationship which had existed for some time between the Great Northern and Northern Pacific. To have separated them and to have linked either one with the Milwaukee would have disrupted their financial and physical structures and might have done considerable damage to both. The final plan created a Great Northern Pacific system which was to compete with the Milwaukee. But such an arrangement created two unequal systems which were supposed to compete. The Great Northern and Northern Pacific were comparatively strong financially; whereas the Milwaukee had been for some time in a precarious financial condition.

Consolidation of the railroads either along the lines indicated by the plans of the Interstate Commerce Commission or according to some other feasible scheme seems to be one possible solution to some of the difficulties of the railroads. It would enable them

[43] U. S. Code, Title 49, Sec. 5 (4).

to eliminate duplication, to cut costs, and to present a united front against the competition with which they are threatened. However, consolidations should be carefully watched in order to protect public interest. They should not be mere schemes to enrich a few promoters and speculators. The public should be protected against inflated values, security pyramids, and excessive fees to manipulators. All too often in the case of public utility mergers the benefits have gone not to the consumer or even to the ordinary investor but to some person or group of persons in control.

Railroad consolidation under the present provisions of the Interstate Commerce Act is voluntary. One must realize that so long as it is voluntary many of the proposed mergers will never occur or that, if they do, they may take place along lines different from the proposals of the commission. In order to give the commission some real power, suggestions have been made that compulsory consolidation be adopted. In fact, measures containing compulsory features have been placed before Congress from time to time. Naturally, compulsory consolidation has been vigorously opposed by strong carriers who have no desire to be saddled with weak lines and also by railroads whose ambitions to expand do not fit into the proposed consolidation plan.

Those who have opposed compulsory consolidation assert that it is but a step toward government ownership.[44] Although there is some truth in this assertion, the same charge can be made against every piece of regulatory legislation. It has been alleged also that to burden strong roads with weak systems is unfair. The unfairness depends upon whether the railroads are still primarily private or whether they are public enterprises which are privately owned and operated and from which a profit can be made. It is too late to assert that railroads are primarily private and secondarily public. The extent to which the courts have allowed government control is a clear indication to the contrary. The objection has sometimes been made that compulsory consolidation would be unconstitutional because it would be taking private property for public use without just compensation in violation of the Fifth Amendment of the United

[44] See the article by H. E. Kentner in the *U. S. Daily*, Sept. 22, 1930, p. 9.

States Constitution. In view of the decisions of the courts sustaining the validity of other drastic pieces of regulatory legislation, it is very doubtful whether they would uphold such a contention. If they could uphold the constitutionality of the *recapture clause* of the Transportation Act of 1920 which took one half of the excess earnings of railways, certainly they can uphold the validity of compulsory consolidation.[45]

III. Security Issues.

The control of security issues, although of direct concern to the investors in railway stocks and bonds, is of secondary interest to the shipping and using public. The railroad patron is interested in such control only insofar as it contributes to the effective regulation of rates and service. It is of tremendous importance, however, that a regulatory body should be invested with this power. Demands for excessive rates are often the result of overcapitalization brought about by the indiscriminate and unwarranted issuance of securities. Effective rate regulation demands some control of security issues.

This control, which was finally given to the Interstate Commerce Commission, was the culmination of a long struggle. As early as 1908 and 1909 the commission urged that it be given this power. In 1910 President Taft placed himself upon record as favoring such legislation.[46] It was not, however, until 1920 that Congress heeded these recommendations and embodied in the Interstate Commerce Act provisions for the control of security issues.

One of the troublesome questions which has arisen pertains to state control of security issues. The statutes of many states contain provisions which require the consent of some state authority before carriers can issue securities. What is the effect of the Interstate Commerce Act upon such provisions of state laws? According to the act, the jurisdiction of the commission is exclusive and plenary, and the carriers need not secure other approval.[47] Evidently it has been intended that this section shall supersede state laws on the subject. State courts have

[45] Dayton-Goose Creek Ry. Co. v. U. S. (1924) 263 U. S. 456, 68 L. Ed. 388, 44 S. Ct. 169.

[46] See "Railroads" by Vanderblue and Burgess, footnote 5, p. 366.

[47] U. S. Code, Title 49, Sec. 20a (7).

declared that statutes requiring state consent have been superseded by this section of the Interstate Commerce Act.[48]

The constitutionality of the paragraphs concerning security issues has been challenged chiefly upon the grounds that Congress has exceeded its power by regulating intrastate commerce. It is true that the money derived from the sale of securities will in all probability be used in part for intrastate commerce. Therefore, it has been argued that to place this control of stocks and bonds in the hands of the Interstate Commerce Commission is an invalid regulation of intrastate commerce. The court has held, however, that a proper regulation of rates resulting in a fair return makes it necessary that the Interstate Commerce Commission be vested with complete authority over the issuance of all securities.[49] The practical aspects of the situation demand that the commission be given general authority over security issues. To determine exactly what part of the money derived from the sale of securities will be used for intrastate and what part for interstate commerce is not feasible, even if possible. Here is another illustration of the power of the Federal government to control intrastate commerce where it is closely and intimately connected with interstate commerce.

The Interstate Commerce Act provides that no carrier by railroad shall issue any capital stock, bond, or other evidence of indebtedness, or assume the obligations of any other person without the approval of the Interstate Commerce Commission. Railways are allowed to issue without authorization certain short-term notes maturing in two years or less. Such short-term notes, however, may not aggregate more than five per cent of the par value of the outstanding securities of the carrier.[50]

Securities which are issued contrary to the provisions of the act are void.[51] Not only has the commission declared that the issues are void, but it has declared that there is no provision for their validation and that they may not be carried upon the books of the carrier.[52] Provision is made for the recovery of damages by

[48] Whitman v. No. Cen. Ry. Co. (1924) 127 At. 112, 146 Md. 580; see also Mpls. St. P. and S. S. M. Ry. Co. (1924) 197 N. W. 352, 183 Wis. 47.

[49] Pittsburgh and W. V. Ry. Co. v. I. C. C. (1923) 293 Fed. 1001.

[50] U. S. Code, Title 49, Sec. 20a (9).

[51] U. S. Code, Title 49, Sec. 20a (11).

[52] Operation of Line by C. K. and S. R. Co. (1928) 145 I. C. C. 427.

innocent purchasers for value of securities issued contrary to this act. Directors or agents who knowingly concur in the issuance of such securities are liable to a fine, imprisonment, or both. The commission has declared, however, that it has no power to punish persons who violate this section, nor has it power to award damages sustained by holders of securities, as these are matters entirely within the jurisdiction of the courts.[53]

In approving or rejecting the applications of railroads to issue securities, the commission is allowed a considerable latitude for the exercise of administrative discretion. The act does provide, however, that the commission is to issue an order authorizing the securities only if it finds: (*a*) that it is for some lawful object within the corporate purpose; (*b*) that it is compatible with public interest and is necessary or consistent with the proper performance by the carrier of service to the public; and (*c*) that it is reasonably necessary and appropriate for such purpose. The commission may grant the request, may refuse it, grant it in part, or grant it upon such terms and conditions as are deemed necessary.[54]

The commission has passed upon scores of applications made under this section of the act. Although the greater number of these requests have been granted, a few have been refused. In granting or refusing permission, the commission has had occasion to construe the words, "for some lawful purpose, compatible with the public interest and reasonably necessary and appropriate for such purpose."

For one thing, the commission has been very careful to guard against overcapitalization. It has gone so far in this respect that it has even refused to allow securities to be issued to the full extent of the valuation of the property when the proposed arrangement would probably result in an immediate receivership. The commission has declared that such elements as commercial value and earning capacity must be given due consideration:[55] "The public interests require that, before an issue of securities by a carrier is authorized, the probability of earnings sufficient to pay costs of operation and of fixed charges be rea-

[53] See Hild v. C. N. S. and M. R. Co. (1929) 150 I. C. C. 367 (370).

[54] U. S. Code, Title 49, Sec. 20a (2 and 3).

[55] Securities of La. Ry. and Nav. Co. (1925) 99 I. C. C. 357.

sonably established, with some surplus for dividends and other purposes."[56]

The purpose for which the carrier desires to use the stocks or bonds is scrutinized very carefully. The commission does not look with favor upon the issuance of securities when there is an intention to distribute them as dividends. The commission particularly disapproves of the issuance of bonds and their distribution as dividends.[57] The chief reason for such disapproval seems to be that such bonds materially increase the interest burden without necessity. Although the commission has less objection to the distribution of stock dividends, it has sometimes refused petitions where the circumstances have not warranted approval.[58] Even when the commission has approved a stock dividend, it has sometimes required that a substantial surplus should remain uncapitalized. This was the situation when the Delaware Lackawanna and Western sought to capitalize its $90,000,000 surplus. The commission allowed the carrier to issue dividends in stock to the extent of $45,000,000, and no more.[59]

Another thing with which the commission concerns itself is the method of sale of railroad security issues. For example, the commission has sometimes required competitive bidding in cases where railroads are planning to market their securities privately. The commission has particularly felt that equipment-trust certificates should be disposed of in this way, probably because they are more standardized and depend less upon the credit of the railway.[60]

IV. Railroad Reorganization.

The financial condition of many of the railroads during the past 20 years has been a cause of much concern to officials of the Federal government. Faced with severe competition from other kinds of carriers and suffering under top-heavy financial structures, the railroads as a whole have been unable to earn a fair

[56] See Denver and Rio Grande Western (1924) 90 I. C. C. 141 (148).

[57] *In re* C. B. and Q. R. Co. (1921) 67 I. C. C. 156; N. Y. Lackawanna and Western Stock and Bonds (1927) 131 I. C. C. 34.

[58] So. Georgia Ry. Capital Stock (1923) 82 I. C. C. 723.

[59] *In re* Stock of D. L. and W. R. (1921) 67 I. C. C. 426.

[60] See "Regulation of Railroad Finance" by J. H. Frederick, F. T. Hypps, and J. M. Herring, p. 184.

return upon their capitalization. In fact, many of them have consistently operated at a loss. It was obvious that many railroads would have to cut their capital structure and undergo reorganization proceedings if they were to continue operation in private hands.

One method of securing relief was through the institution of equity receiverships, and many carriers availed themselves of the opportunities offered by this kind of procedure. Unfortunately these proceedings were often slow and difficult and were sometimes conducted primarily in the interests of certain promoters rather than for the welfare of the holders of stocks and bonds.

In order to give another method of reorganization and to provide more stringent control, Congress passed an amendment to the Bankruptcy Act. This amendment is commonly known as Section 77. The outstanding feature of this procedure is the part which the Interstate Commerce Commission plays in the reorganization. Under the provisions of Section 77, a petition may be filed in a district court of the United States stating that a railroad corporation is insolvent or unable to meet its debts and that a reorganization is desired. The petition may be filed by the railroad or creditors having claims which aggregate not less than 5 per cent of the indebtedness of the railroad. The petition must be approved by the judge, who then appoints a trustee to operate the business of the railroad. A hearing must be held before the Interstate Commerce Commission on proposed plans of reorganization. After the hearing, the commission either recommends one of the proposed plans or suggests a new one. The plan must be accepted by a certain percentage of the stockholders. The commission then certifies the plan to the court and after a hearing, the judge confirms it if he finds that certain situations mentioned in the statute exist.[61] In 1937, 30 railroads were availing themselves of the opportunities offered for reorganization under Section 77. Included in this group were such large systems as the North Western, the Milwaukee, the Great Western, the New York New Haven and Hartford, and the Western Pacific.[62]

Undoubtedly the continuance of private ownership and operation of the railroads depends in part upon the success of

[61] Public Act No. 381, 74th Congress, 1st Session.

[62] Annual Report of the Interstate Commerce Commission, 1937, p. 164.

reorganization proceedings. If the railroads, the courts, and the Interstate Commerce Commission can work out plans that will enable the carriers to earn something approaching a fair return upon their capitalization, the demands for government ownership and operation will be less urgent.

V. Loans to Railroads.

Beginning with the Transportation Act of 1920, the Federal government gave evidence of a new attitude toward the railroads. Formerly it was interested in regulation, but since 1920 it has given consideration to the financial needs of railroads by making arrangements for loans to carriers. The first of these schemes was the revolving fund created by the Transportation Act of 1920, from which the railroads were permitted to borrow money to carry them over the period of transition from government to private control.[63] The next scheme was the Railroad Credit Corporation fund which was established in 1931 when the railroads were requesting a general 15 per cent increase in rates. The commission allowed them certain increases but required that the money derived therefrom should be placed in a fund to be loaned to needy carriers.[64] The most important and comprehensive scheme for loans to railroads was set up by the Reconstruction Finance Corporation Act. Under this act, railroads were given permission to borrow extensively from the Reconstruction Finance Corporation upon obtaining the consent of the Interstate Commerce Commission.[65]

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U. S. Code, Title 49, Sec. 1 (18) (21) (22).

[63] Sec. 210 of the Transportation Act of 1920. For the status of this fund in 1931 see p. 341, Annual Report of the Interstate Commerce Commission, 1931.

[64] Fifteen Per Cent Case (1931) 178 I. C. C. 539. See p. 1, *U. S. Daily*, July 5, 1932, for an account of the working of this scheme.

[65] For a discussion of the Reconstruction Finance Corporation, see Chap. XXIII.

In re Crystal and San Juan Railroad Company (1922) 72 I. C. C. 561.
In re I. C. and St. L. Ry. Co. (1922) 71 I. C. C. 668.
In re Wichita Northwestern Ry. Co. (1922) 71 I. C. C. 42.
In re Mich. No. R. R. Co. (1920) 65 I. C. C. 480.
I. C. C. v. Oregon–Wash. R. R. and Nav. Co. (1933) 288 U. S. 14, 77 L. Ed. 588, 53 S. Ct. 266.
U. S. Code, Title 49, Sec. 1 (10) (11) (13) (14) (21).
In re Private Cars (1918) 50 I. C. C. 652.
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In re Train Service on the Northern Pacific (1926) 112 I. C. C. 191.
"Public Utility Service and Discrimination" by Ellsworth Nichols, pp. 71–78.
Railroad Com. of Wis. v. Chi. and N. W. Ry. Co. (1924) 87 I. C. C. 195.
U. S. Code, Title 49, Sec. 3 (3) (4).
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"Railroads" by Vanderblue and Burgess, Chaps. XVI, XX, and XXIV.
I. C. C. v. U. S. *ex rel.* Los Angeles (1929) 280 U. S. 52, 74 L. Ed. 163, 50 S. Ct. 53.
A. T. and S. F. Ry. Co. v. Railroad Com. (1931) 283 U. S. 380, 75 L. Ed. 1128, 51 S. Ct. 553.
Brooks Scanlon Lumber Co. v. Ry. Com. of La. (1920) 251 U. S. 396, 40 S. Ct. 183, 64 L. Ed. 323.
Texas v. E. Tex. R. R. Co. (1922) 258 U. S. 204, 66 L. Ed. 566, 42 S. Ct. 281.
Colorado v. U. S. (1926) 271 U. S. 153, 70 L. Ed. 878, 46 S. Ct. 452.
U. S. Code, Title 49, Sec. 5 (1) (2) (4).
In re Consolidation of the Railroads (1929) 159 I. C. C. 522; *In re* Consolidation of the Railroads (1932) 185 I. C. C. 403.
U. S. Code, Title 49, Sec. 20a (2) (3) (7) (9) (11).
Securities of Ry. and Nav. Co. (1925) 99 I. C. C. 357.
South Georgia Ry. Capital Stock (1923) 82 I. C. C. 723.
In re Stock of Del. Lack. and W. R. (1921) 67 I. C. C. 426.
"Regulation of Railroad Finance" by J. H. Frederick, F. T. Hypps, and J. M. Herring.
Annual Reports of the Interstate Commerce Commission, 1931–1937.
U. S. Code, Title 11, Sec. 5.

CHAPTER VII

REGULATION OF RAILROADS

(Continued)

VI. Rates.

No phase of railroad regulation is more important than rate control. Regulation of security issues, consolidation, terminal facilities, new lines of road, and accounts are of secondary importance to the shipping public. For the average user of the railroad the important question is how much must he pay for the service which the carrier is offering?

Rate control has two phases, securing just and reasonable *particular rates* and securing a just and reasonable *general rate level*. In the first of these, the regulatory agent seeks to secure proper rates on particular commodities either between certain points or between all points within a given area; in the second, the regulatory agent seeks to fit particular rates into a larger pattern so as to secure a general rate level which will enable the carrier to make a fair return upon the value of its property. These two phases of rate control are closely connected—much as are the parts of a picture to the whole.

Although the tendency has been for the Federal government to play an increasingly important part in rate regulation, the states have not been completely deprived of rate control. State regulation of the rates charged by the carriers for intrastate commerce still exists.[1] Under some circumstances, however, such control of intrastate traffic must give way to the paramount authority of the Federal government to regulate interstate commerce. One case will illustrate this principle. The State of Wisconsin fixed intrastate passenger rates at 2 cents per mile.

[1] See, for example, Orders No. 981, 991, and 994 in which intrastate rates were fixed by the Railroad Commission of Florida on bricks and roofing material. These orders are reported in the Annual Report of the Commission for 1929.

The Interstate Commerce Commission increased the rates for passenger traffic, both intrastate and interstate, to 3.6 cents per mile. The Superme Court of the United States upheld the order of the commission, even though it applied to intrastate rates. To have allowed a continuance of the 2-cent rate for intrastate commerce would have seriously hampered interstate commerce by forcing it to bear too great a proportion of railroad expenses.[2] The Interstate Commerce Act expressly gives to the commission the power to prescribe rates for intrastate commerce when necessary to remove discriminations against interstate and foreign commerce.[3]

1. *Particular Rates.* In the regulation of rates, commissions perform both quasi-judicial and quasi-legislative functions. The determination of the reasonableness of existing rates is the exercise of a quasi-judicial function; whereas the establishment of rates is the exercise of a quasi-legislative function. Both are necessary to maintain adequate rate control. In general, both state and Federal commissions have been vested with quasi-judicial and quasi-legislative powers over rates.

Under both state and Federal law, railroads are under the obligation to charge just and reasonable rates for the transportation of passengers or property.[4] In order to enforce this duty, the Interstate Commerce Commission has the power to determine whether or not existing rates are just and reasonable and to prescribe maximum, minimum, and even absolute rates.[5] State commissions have been granted similar authority, which in some cases is as extensive but in others is not so extensive as that granted to the Interstate Commerce Commission.[6]

Railroad regulatory statutes use the expression, *just and reasonable rates*, but do not usually define or clarify the term or indicate the factors which are to be used in arriving at the justice and reasonableness of rates. This throws the burden upon

[2] Railroad Com. of Wis. v. C. B. and Q. R. Co. (1922) 257 U. S. 563, 66 L. Ed. 371, 42 S. Ct. 232.

[3] U. S. Code, Title 49, Sec. 13 (4).

[4] U. S. Code, Title 49, Sec. 1 (5). See also the numerous statutes of the states dealing with railroads.

[5] U. S. Code, Title 49, Sec. 15 (1).

[6] See, for example, Sec. 35 of the New York Public Service Commission Law; Secs. 32 and 33 of the Public Utilities Act of California; and Sec. 6703 of the Compiled General Statutes of Florida, 1927.

commissions and the courts. As the concept of a reasonable and just rate is very indefinite, it is impossible to give any precise mathematical formula which can be applied in every case.[7] About all that can be done is to enumerate a few factors. Numerous ones have been suggested, but apparently no one factor is controlling, nor is there any certainty as to the weight which should be accorded to each.[8]

It has been suggested that one of the chief factors should be the cost of service. In other words, a reasonable rate should be based in part upon cost plus a profit. Ideally, this seems just, but a close scrutiny will reveal the difficulty of using this as a basis. One author has declared, "Cost is simply not ascertainable."[9] One engine will pull a train loaded with dozens of different commodities, oil, iron ore, coal, furniture, automobiles, and silk. Even within one car there may be several kinds of commodities. To allocate to each of these commodities all of the costs of its carriage is an extremely difficult if not an impossible task. To determine the share of executive salaries or maintenace of the right-of-way which should be borne by a carton of butter or a crate of eggs is no small task. However, calculations can be made and are made which give a rough estimate of the cost of performing a particular service.

Another factor is the value of the service to the shipper.[10] Again a difficulty appears. How can this be determined accurately? It has been suggested that the value of a service to the shipper is the difference in the price of a commodity between the point of origin and the point of destination. To use the sug-

[7] *In re* Awarding Reparation (1922) 68 I. C. C. 5 (6): "We have often recognized the principle that 'just and reasonable' imply the application of good judgment and fairness, of common sense and a sense of justice, to the facts of record. The words 'just and reasonable' are not fixed, unalterable, mathematical terms . . . Moreover, as has been recognized by the Supreme Court there must exist range for 'the flexible limit of judgment which belongs to the power to fix rates' . . . There could be no flexible limit of judgment if all rates were to be measured by their relation to cost or by a predetermined rule."

[8] For a list and discussion of the more important factors see "Rate-making for Common Carriers" by G. H. Alldredge, p. 43.

[9] "Railroads" by Vanderblue and Burgess, p. 87. For a discussion of this whole problem, see Chap. VII of this same work.

[10] See statement of the Commission in Interstate Rates on Grain, Grain Products, and Hay (1921) 64 I. C. C. 85 (98).

gested criteria is merely to reason in a circle, because the selling price of a commodity depends to a great extent upon the cost of transportation.[11] The Interstate Commerce Commission has sometimes declared that the value of the service can be determined by the rates the commodity will bear without curtailing the movement.[12] In spite of the difficulties of determining the value of the service, it is supposedly one of the factors which should be used in arriving at the reasonableness and justice of rates.

Many other factors may properly be considered. The value of the commodity is one of these.[13] The greater the value, the greater is the risk assumed by the carrier. Furthermore, the greater the value, the greater is the ability of the commodity to stand a high transportation charge. The volume of traffic is also important since the greater the volume of traffic, the stronger is the justification for a lower rate. The physical characteristics of the commodity, that is, its carloading characteristics, its size, shape, susceptibility to breakage, and its weight are also important considerations.[14]

2. *General Rate Level.* In the case of a general rate level, the theory is that the general rate structure should be regulated so as to produce for the carriers as a whole a fair return. Obviously the attainment of this end must rest primarily with an agent of the Federal government rather than with agents of the state governments. In 1920 Congress provided for the control of rates as a whole by the Interstate Commerce Commission in a straightforward and clear-cut statement.[15] In 1933 the following somewhat ambiguous statement was substituted for the original provision:

> In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need

[11] See "Railroads" by Vanderblue and Burgess, footnote 2, p. 91.

[12] See statement of the Commission in Lignite Coal from North Dakota (1927) 126 I. C. C. 243 (247).

[13] See "Rate-making for Common Carriers" by J. H. Alldredge, p. 61.

[14] See "Rate-making for Common Carriers" by J. H. Alldredge, Chap. IV.

[15] Transportation Act of 1920, Sec. 422, 41 Stat. L. 488.

of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service.[16]

In the above statement Congress does not appear to have given the Interstate Commerce Commission any very definite criteria upon which to base the general rate level. Numerous decisions of the courts have indicated, however, that businesses affected with a public interest should be allowed to earn a fair return upon the value of their property over and above operating expenses. Therefore in determining the proper level of rates as a whole three questions of importance appear: (1) what are reasonable operating expenditures; (2) what is the aggregate value of railroad property; and (3) what is a fair return?

(1) If the rates are to be set at a level so as to yield a fair return over and above operating expenses, it is necessary that such expenses should be kept within proper limits. Otherwise there may be some temptation for railroads to increase their operating expenses with the expectation of passing the burden on to the public in the form of increased rates. At least there is little incentive for roads to keep their expenses within reasonable limits if they know that they can charge enough to get a fair return over and above any expenses which they may incur. Without restrictions, there may be some temptation to increase executive salaries or wages beyond a reasonable level, to advertise extravagantly, or to make large donations to charities and then charge such expenditures to operating expenses, hoping to receive a fair return over and above the same.

(2) The second important consideration, aggregate value, presents many difficulties. It is no easy task to value a railroad, or any public utility, for that matter. Many bases are possible, but none of them is free from objections.

In determining the aggregate value of the carriers, the Interstate Commerce Commission does not have the authority to choose any base which it deems advisable but must be guided by certain statutory provisions. In 1913 Congress passed the Valuation Act as an amendment to the Interstate Commerce Act.[17] Under the terms of this act the commission was ordered to ascertain and report as to each piece of property owned or used by the carriers for common carrier purposes, the original

[16] U. S. Code, Title 49, Sec. 15a.

[17] The provisions are now found in the U. S. Code, Title 49, Sec. 19a.

cost to date, the cost of reproduction new, the cost of reproduction less depreciation, and other values or elements of value of such property. Furthermore, the commission was to investigate and report the original cost of all lands, rights of way, and terminals used for purposes of a common carrier. The commission was also required to determine the present value of these same things. No indication was given to the commission as to the weight to be accorded to each of the factors in arriving at a final valuation.

When the commission completed its tentative valuation of any common carrier, the act required it to notify the carrier, the attorney general of the United States, and the governor of the state in which the property valued was located and to allow them 30 days in which to file a protest with the commission. If no protest was filed within the 30 days, the valuation was to be final. In case of a protest, the commission was to hold a hearing and if it was of the opinion that its tentative finding should not be made final, it should make necessary changes. Such final value was to be prima facie evidence of the value of the property in certain judicial proceedings brought under the act.

This task which Congress placed upon the commission was tremendous. To find the elements of value requested by Congress seemed to many persons almost impossible. Nevertheless, the commission set about its work and gradually reported its valuations for the various carriers.

In seeking to ascertain the *cost of reproduction new*, the commission attempted to assume the "mental obliteration" of the road, that is, it assumed that the road was to be completely rebuilt.[18] To reproduce the railroad under such circumstances, allowance was made for the cost of securing a charter and for legal expenses incidental to the organization of the company. Allowance was made for the cost of raising funds needed to embark upon the venture. The cost of organizing and placing engineering parties in the field and the cost of clearing and grading the land were important items. Even interest during construction was given consideration. It was necessary also to estimate the cost of reproducing all physical equipment such as ties, rails, cars, etc.[19]

[18] See "Railroad Valuation by the Interstate Commerce Commission" by H. B. Vanderblue; see also Texas Midland Railroad (1918) 75 I. C. C. 1.

[19] See the discussion beginning on page 11 of "Railroad Valuation by the

When the commission had found the cost of reproduction new, it was necessary to determine the extent to which the property of the carrier had depreciated. In making this estimate many difficult problems presented themselves. The various items of physical equipment could be assigned normal life spans and the length of time during which they had been in use could be made a basis for determining the extent of depreciation. This had to be varied in many cases, however. Sometimes the engineers found that, because of improper care or unusual weather conditions, the equipment was more than normally depreciated. At other times the engineers found that, because of excellent care or unusually favorable circumstances, the equipment had not undergone the customary depreciation. Allowances had to be made accordingly. Furthermore, consideration had to be given to the question of *functional* depreciation. That is, some kinds of property, although still in good condition, had become obsolete. Wooden bridges, wooden passenger cars, and obsolete types of locomotives furnished well-known illustrations of depreciation of this character. In such cases, not only the condition of these pieces of property had to be considered, but the fact of their obsolescence as well.[20]

In securing the "present value" of the carrier's land, the commission divided the property of a railroad into zones containing land approximately equal in quality. Efforts were made to estimate the value of the railroad land by determining the value of the land adjacent thereto. But such comparison was not always satisfactory because in many cases adjacent land had been transferred under foreclosure or transferred to settle an estate, at a price far below the actual value.[21]

The commission encountered great difficulty in ascertaining original cost due to the fact that the carriers had not kept accurate records or had not followed uniform systems of accounting in the early days of their existence.

Interstate Commerce Commission" by H. B. Vanderblue; see also Texas Midland Railroad (1918) 75 I. C. C. 1.

[20] For a discussion of this question see "Railroad Valuation by the Interstate Commerce Commission" by H. B. Vanderblue, p. 41.

[21] See "Railroad Valuation by the Interstate Commerce Commission" by H. B. Vanderblue, p. 52.

When the commission completed an estimate of the items mentioned above, it proceeded to make its valuation report. In general, the valuation was made up of the following items: the cost of reproduction new less depreciation, the present value of the carrier's land, and an allowance for "working capital." The commission usually found that the original cost of the carrier could not be ascertained.[22]

The commission declared that the allowance for "working capital" included investment in materials and supplies, cash necessary to pay operating expenses incurred for service prior to the time when revenues were available, and a buffer fund for cash constantly on hand to cover amply the recurrent and fluctuating deficiencies in the inflow of revenue applicable to payments falling due.[23]

The carriers made a strong plea for a separate allowance for "going concern value." The "going concern value" was supposed to represent the difference in value between a firm actually assembled, established, and doing business and a firm not thus far advanced. Although many state commissions allowed utilities to add a certain sum to their valuation for going value, the Interstate Commerce Commission refused such an allowance and answered the carriers contention as follows:

> We have considered and valued the carrier as it actually existed on valuation date, a live, going, business concern. The evidence does not warrant the inclusion of the separate sum for going value contended for by the carrier.[24]

The arduous labors of the Interstate Commerce Commission in finding aggregate values were upset in part by the United States Supreme Court in the case of *St. Louis and O'Fallon Railway Company v. United States.* In this decision the question was raised as to the valuation of the carrier's property in 1921, 1922, and 1923.[25] In making its valuation, the commission had assumed that the unit prices of 1914 should be taken as a basis for all property installed prior to 1914 (this constituted the bulk

[22] See, for instance, the valuation reports, Lake Tahoe Ry. and Trans. Co. (1927) 125 I. C. C. 327; Mount Hope Mineral R. Co. (1927) 125 I. C. C. 321.

[23] Mount Hope Mineral R. Co. (1927) 125 I. C. C. 321 (334).

[24] E. Jersey Railroad and Terminal Co. (1926) 114 I. C. C. 441 (444).

[25] (1929) 279 U. S. 461, 73 L. Ed. 798, 49 S. Ct. 384.

of the railroad property). To this the carrier took exception, asserting that the commission had not obeyed the Valuation Act of 1913. The United States Supreme Court upheld the contention of the railway and found that the commission had failed to follow the legislative mandate with regard to valuation since it had not given consideration in its finding to current or reproduction costs (in this case 1921 to 1923) on the bulk of the property but had found the cost of reproduction of most of the property as of 1914. The commission should have found the cost of reproduction for the years 1921 to 1923.

The whole scheme for valuation of the railroads has given rise to much criticism. In the first place, under the Act of 1913 the legislature did not designate the weight to be given to each of the factors therein specified, leaving it uncertain as to what should constitute the "backbone" of valuation. A more serious objection has been raised, namely, that the whole valuation plan is impracticable. Probably it was intended that a valuation should be made of all the carriers and that the commission was to keep this up to date. Even this would be difficult except with a large staff of employees. New figures for land, reproduction cost, and depreciation must be secured continually and almost as soon as these have been found for a certain date, they are obsolete.[26] As long as the cost of reproduction new less depreciation is used as a basis, these difficulties cannot be avoided. If, however, a more stable basis, such as "prudent investment," could be adopted, many of the difficulties would disappear.

(3) The third important consideration in fixing group rates is a fair return. The Transportation Act of 1920 fixed this very definitely for the years 1920 to 1922 by providing that 5½ per cent per annum should be taken as a fair return upon the aggregate value of the property, and that the commission might in its discretion add to this a sum not to exceed ½ of 1 per cent.[27] After that period the commission was to determine from time to time what percentage would constitute a fair return. Congress provided also that if any carrier received for the year a net railway operating income in excess of 6 per cent, one half of such excess was to be placed in a reserve fund by the carrier, and the

[26] For a discussion of these difficulties see an article in the *U. S. Daily*, Sept. 25, 1930, p. 11.

[27] Transportation Act of 1920, Sec. 422, 41 Stat. L. 489.

other half was to be paid to the commission and to be used for loans to needy carriers. This was the famous "recapture clause" of the Transportation Act of 1920.[28]

The "recapture clause" did not prove the success that its originators had hoped and contemplated. In the first place, except for government contributions, practically no money was available for loans to carriers under its provisions. It has been estimated that the railroads for the period from 1920 to 1930 owed recapturable sums ranging from $350,000,000 to $400,000,000.[29] Most of the roads refused to pay this money into the railroad contingent fund. To obtain that which was due would have necessitated the institution by the Interstate Commerce Commission of dozens of lawsuits against the carriers. Altogether, the railroads paid into the fund about $10,000,000, but nearly all of this amount was paid under protest.[30] Finally, in 1931 the "recapture clause" was repealed.

Since 1920 the Interstate Commerce Commission has assumed on several occasions that 6 per cent is a fair return, and there is no reason to believe that it has altered its point of view. During this period, however, railroads as a whole have made annual returns usually much below 6 per cent.

VII. Accounts.

Although the regulation of accounting is of tremendous importance for effective control of carriers, it is only of indirect interest to the public. The public is interested primarily in adequate service at reasonable rates. Only insofar as accounting assists commissions in their control of rates and service is it of importance to the shipping or using public. Despite the fact that it is of secondary importance to users, accounting control is fundamental to the whole system of regulation. It is necessary in order to carry out effectively the provisions concerning valuation, consolidation, abandonment, and rates. The keeping of accurate financial information, the uniformity of such data, and its availability for the scrutiny of public authorities are all of utmost importance to intelligent and effective decisions on many important railroad questions. One of the great difficulties which the

[28] U. S. Code, Title 49, Sec. 15a.
[29] See *U. S. Daily*, Aug. 27, 1931, p. 8.
[30] Annual Report of the Interstate Commerce Commission, 1931, p. 90.

Interstate Commerce Commission encountered in its valuation of the carriers was the impossibility of determining original cost due to the lack of adequate financial records of the carriers during their early history.

The Interstate Commerce Commission may prescribe the forms of any and all accounts, records, and memoranda of railroads.[31] In 1914 the commission issued general classifications of accounts for railroads which form the basis for their accounts today. The first classification includes expenditures for road and equipment. The next two classifications pertain to operating expenses and revenues. Other classifications include income, profit and loss, and general balance sheet accounts.[32] Each of these above classifications contains detailed information and is subdivided very minutely and carefully so that all possible railroad revenues or expenditures may be included and assigned to their proper place. The commission has had for some time under preparation a revision of the 1914 classification, but so many objections have been raised and so many difficulties have appeared that it has postponed its issuance several times.[33]

Both Federal and state commissions have access to the accounts, records, and memoranda of railroads and require them to make certain reports at regular intervals. The policing of carriers' accounts is a very important task. However, because of an inadequate staff and the necessity of performing certain special tasks prescribed by Congress, the Bureau of Accounts of the Interstate Commerce Commission has found itself unable in recent years to police accounts to its own satisfaction.[34]

VIII. Discrimination.

Much of the agitation for the control of the railroads arose from certain pernicious and prevalent discriminatory practices. The tremendous possibilities for injustice through the making of unequal charges or rendering unequal facilities placed the rail-

[31] U. S. Code, Title 49, Sec. 20 (5).

[32] For these classifications and a general discussion thereof see "American Railroad Accounting" by Henry Carter Adams.

[33] See the reports of the Bureau of Accounts in the Annual Reports of the Interstate Commerce Commission, 1931–1933.

[34] See the Annual Report of the Interstate Commerce Commission, 1923, p. 26; see also its report for 1924, p. 26; and its report for 1935, p. 41.

roads in a powerful and advantageous position. Since most shippers were absolutely dependent upon carriers by rail, it was possible for railways, through inequality of treatment, to ruin one patron while contributing materially to the prosperity of another. One shipper might fail and another succeed largely because of railroad discrimination.[35] No doubt the alarming potentialities of such power as well as actual instances of abuse led to the incorporation of certain sections in the various railroad regulatory statutes which were directed at the eradication of discrimination. Much of the time of the Interstate Commerce Commission and the state commissions is spent on cases involving inequality of treatment.[36]

The power to prevent and eradicate discrimination in its various forms is shared by state and Federal regulatory agents, the former controlling discriminations in intrastate commerce and the latter those which pertain to interstate commerce. However, the Interstate Commerce Act gives to the Interstate Commerce Commission the power to fix intrastate rates where necessary to remove discriminations against interstate and foreign commerce.[37]

The railroad statutes of the various states dealing with discrimination are numerous and vary much in detail.[38] Many of them are quite similar to provisions of the Interstate Commerce Act.[39] For this reason, the treatment of discrimination will be confined largely to the provisions of the Interstate Commerce Act. The principal parts of this act which are designed to secure equality of treatment are: the antipass provision, the section forbidding discriminations in rates, the

[35] For a discussion of railroad discrimination and its importance see the article in the *Annals of the American Academy* by C. A. Prouty, Vol. 15, p. 41.

[36] For a collection of cases and statutory material dealing with discrimination, preferences, and the long- and short-haul clause of the Interstate Commerce Act, see "Government and Railroad Transportation" by Albert R. Ellingwood and Whitney Coombs, pp. 195–267.

[37] U. S. Code, Title 49, Sec. 13 (4); Las. Pub. Ser. Com. v. Tex. and N. O R. Co. (1931) 284 U. S. 124, 76 L. Ed. 201, 52 S. Ct. 74.

[38] See, for example, Sec. 38 of the Illinois Commerce Commission Law; Sec. 4838 of the General Statutes of Minnesota for 1923; Sec. 6699, Compiled General Laws of Florida, 1927.

[39] See, for example, Secs. 31, 32, 33, and 36 of the Public Service Commission Law of New York.

section prohibiting preferences, the long- and short-haul clause, and the section requiring the publication of tariffs and the payment of charges in money.

1. *Passes.* Indiscriminate grants of free transportation to passengers had become a common practice during the latter part of the nineteenth century and the early part of the twentieth century. Persons who found themselves in a favored position demanded passes not only for themselves but for members of their families and in some cases for remote relatives. Such persons often requested not merely single passes but annual passes, and even permanent passes, which were valid for all railroads. If a carrier refused even an unreasonable request, it might find that it had aroused the enmity of a person in a position to retaliate.[40]

In many cases passes were granted to favored shippers, but the issuance of passes to persons holding important political positions was especially to be deplored. To grant free transportation to a city official, a member of a state or the national legislature, an executive officer, or other person in a position of political importance was an excellent device for making them feel kindly disposed toward the carrier. The cost to the railway was more than compensated for by favorable political action or inaction.

Undoubtedly even under the original Interstate Commerce Act of 1887, the issuance of free passes constituted discrimination.[41] But the provisions of the act were not adequate to eliminate the evils of this practice. Finally, in 1906, under the Hepburn Act, Congress enacted legislation which prohibited the issuance of passes or free transportation to all persons except those in certain classes designated by the act.

As the law stands at present, no common carrier may grant any pass or free transportation to passengers except its employees and their families and certain other persons working for railroads or allied transportation agencies, such as sleeping-car companies, caretakers of goods which are being transported, certain government inspectors, and certain persons engaged in religious and charitable work.[42]

[40] For a statement of the evils of free passes see the letter of J. T. Brooks, who was at one time second vice-president of the Pennsylvania Railway, *Congressional Record*, Vol. 40, p. 4996.

[41] See *ex parte* Koehler (1887) 31 Fed. 315.

[42] U. S. Code, Title 49, Sec. 1 (7) and Sec. 22 (1).

It is to be noted that the term "family" appears only in connection with employees of carriers. The families of other persons are not entitled to passes. The term family as used in this section has a somewhat restricted meaning. It does not include all ascendants or descendants of employees, but only dependents. In so holding, the courts pointed out that this provision was inserted to enable a railroad to move its employees freely from place to place as the demands of the service required and that the privilege of free transportation was allowed to members of the employee's family in order to facilitate such movement.[43]

The courts have been strict in their interpretation of this section and have refused to sanction free transportation for persons other than those enumerated. It has been held, for example, that a person injured in a railway accident is not entitled to a pass issued in settlement of his claim against the carrier. In one case the Supreme Court even held that an agreement to issue annual passes as compensation for injuries incurred before the Hepburn Act was unenforceable after the date of the act.[44]

2. *Discrimination in Rates.* Section 2 of the Interstate Commerce Act, which deals with rate discriminations, provides as follows:

> If any common carrier subject to the provisions of this chapter shall, directly or indirectly, by any special rate, rebate, drawback, or other device, charge, demand, collect, or receive from any person or persons a greater or less compensation for any service rendered, or to be rendered, in the transportation of passengers or property . . . than it charges, demands, collects, or receives from any other person or persons for doing for him or them a like and contemporaneous service in the transportation . . . of a like kind of traffic . . . under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination, which is prohibited and declared to be unlawful.[45]

This section has a limited application. In the first place, it does not apply to discriminations other than in rates and charges. Furthermore, it does not prohibit all differences in rates but

[43] See Wentz v. C. B. and O. R. Co. (1914) 259 Mo. 450, 168 S. W. 1166.

[44] L. and N. R. Co. v. Mottley (1911) 219 U. S. 467, 55 L. Ed. 297, 31 S. Ct. 265.

[45] U. S. Code, Title 49, Sec. 2.

qualifies the prohibition by saying the discriminations must pertain to *contemporaneous services, like services, like kinds of traffic,* and *be rendered under substantially similar circumstances and conditions.* These terms need explanation.

Services to be *contemporaneous* need not be rendered on the same day, nor during the same week, nor even in the same month.[46]

The term *like kinds of traffic* has been construed strictly. To constitute a discrimination under Section 2, the Interstate Commerce Commission has taken the position that the rates complained of must apply to shipments of commodities which are almost identical. In one case it declared that a difference in rates between wheat on one hand and oats, barley, and rye on the other did not constitute a violation of Section 2.[47] In another case the commission stated that sugar and coffee were not like kinds of traffic within the meaning of this section.[48] In still another case the commission held that since crude iron ore and ground iron ore were not like kinds of traffic, an allegation of unjust discrimination was unfounded.[49]

This section also provides that the rates must be applicable to *like services* before a question of discrimination can arise thereunder. In interpreting this term the Interstate Commerce Commission has declared that to constitute *like services* the movement of commodities must be over the same *line haul.* If over a different line or a substantially different haul, Section 2 has no application.[50] In other words, this section has no application to discrimination against localities.

Finally, the services for which differences in rates are charged must be rendered under *substantially similar circumstances and conditions* before the carrier can be held liable for discrimination under Section 2. A difference in the cost of service is one of the principal justifications for a difference in rates. A court declared in an early case that it was not unfair discrimination

[46] Mitchell Coal Co. v. Penn. R. Co. (1910) 181 Fed. 403.

[47] Board of Trade of the City of Chicago v. C. and A. R. Co. (1913) 27 I. C. C. 530.

[48] Traffic Ass'n v. Ill. Cen. R. Co. (1913) 28 I. C. C. 484 (487).

[49] Winters Metallic Paint Co. v. C. M. and St. P. Ry. Co. (1924) 93 I. C. C. 427.

[50] Tide Water Oil Co. v. Director General (1921) 62 I. C. C. 226; Standard Oil Co. v. Director General (1924) 87 I. C. C. 214.

to offer a lower rate to shippers who sent 20 parcels tied together and consigned to one person than the rate given to shippers who sent 20 packages of the same goods to different persons.[51] Where a special facility or service is furnished in connection with a shipment, a difference in rates is justifiable. For example, if rapid transit, quick delivery, refrigeration, or heating are provided, a higher charge is justifiable than when no such service is afforded. Likewise, the railroad is justified in making an allowance to a shipper or receiver who furnishes his own cars.[52] Also, the carrier may make an allowance to a sender or receiver of goods who provides switching facilities which are part of the transportation of goods.[53] Obviously, allowances for services and facilities must be reasonable.

On the other hand, the courts have held that the nonownership by the shipper of goods which he is sending does not create a dissimilarity of circumstances within the meaning of Section 2. Therefore, it has been held that a railroad is not justified in charging a higher rate to a forwarding agent who ships goods of many other persons in carload lots than it charges to other shippers of carload lots.[54]

Apparently Section 2 forbids a carrier to make an allowance to one shipper which is not given to another who ships over the same line, when the only justification for such difference is competition with another carrier for business of the former shipper.[55] To hold otherwise would tend to nullify the purpose and effect of Section 2 since it would allow the carrier, on the pretext of competition, to grant rebates to one customer and refuse them to another.

The problem of whether or not rebates may be granted to customers who ship their goods entirely over one railroad has occasionally arisen. The cases on this point are not numerous

[51] See the statement of the court in Hays v. Penn. R. Co. (1882) 12 Fed. 309 (312).

[52] See *In re* Private Cars (1918) 50 I. C. C. 652 where the commission discusses the question of allowance for furnishing such facilities.

[53] See N. Y. C. and H. R. Co. v. Gen. Elec. (1916) 219 N. Y. 227, 114 N. E. 115.

[54] I. C. C. v. D. L. and W. R. Co. (1911) 220 U. S. 235, 55 L. Ed. 448, 31 S. Ct. 392.

[55] Wight v. U. S. (1897) 167 U. S. 512, 42 L. Ed. 258, 17 S. Ct. 822; I. C. C. v. Tex. and P. Ry. Co. (1892) 52 Fed. 187.

and are somewhat conflicting.[56] There is no more reason for permitting rebates in this case than in cases of competition.

In general, the mere quantity of goods shipped does not create a dissimilarity of circumstances or conditions justifying a lower rate to a large shipper.[57] To allow a railroad to discriminate in favor of the large shipper would defeat one of the principal purposes of the original Interstate Commerce Act. Yet, in ordinary private business the practice is to grant reductions for quantity purchases. The rule that the carrier may not charge lower rates for quantity transportation does not apply universally. The commission has held that it is not unfair discrimination to charge a lower rate for carload lots than for less-than-carload lots.[58] The justification for permitting a difference in rates in this case lies in the difference in the cost of handling commodities. On the other hand, the commission has held that there is no ground for a difference in rates between carload and trainload shipments.[59] The unit of shipment is the carload. To allow this difference would work an injustice against most shippers of goods since few could comply with the trainload requirement in order to obtain lower rates.[60]

The courts have decided that there is no objection to the sale of party tickets to groups of passengers. In the case of party tickets the carrier sells one ticket to parties of 10 or more persons at less than the price of ten or more individual tickets. Because of a dissimilarity of circumstances, such an arrangement has been held not to constitute a violation of Section 2.[61] Likewise, commutation and excursion tickets may be sold at reduced rates.[62] We have in these cases an interesting contrast to the rule which forbids lower rates to quantity shippers of freight. The difference appears to be justified because there is no great menace to the users of the railway by granting lower rates in the case of

[56] For a discussion of this point see "Railroad Rate Regulation" by Beale and Wyman, Sec. 690, 2d ed.

[57] U. S. v. Tozer (1889) 39 Fed. 369.

[58] Thurber v. N. Y. C. and H. R. R. Co., 3 I. C. C. 473.

[59] Rickards v. A. C. L. Ry. Co. (1912) 23 I. C. C. 239.

[60] See statement of the commission in Wells Lumber Co. v. C. M. St. P. Ry. Co. (1916) 38 I. C. C. 464.

[61] I. C. C. v. B. and O. Ry. Co. (1892) 145 U. S. 263, 36 L. Ed. 699, 12 S. Ct. 844.

[62] This is allowed expressly in U. S. Code, Title 49, Sec. 22(1).

passenger traffic. A passenger cannot be greatly injured because other passengers who are traveling in groups receive lower rates; whereas a small shipper can be completely ruined because a large rival receives rebates for quantity shipments.

Regardless of its form, any device which gives a rebate or lower rate is illegal. For example, a carrier was held to have violated the law because it procured a loan of money for a shipper and charged only two per cent interest when the market rate of interest was higher.[63] Likewise it was declared unjustifiable for a railway to lease valuable lands to shippers of freight over their lines at a nominal rental.[64]

3. *Unreasonable Preferences.* As previously noted, Section 2 of the Interstate Commerce Act has application only to discrimination pertaining to rates or charges over the same line haul. In order to eradicate discriminations of all kinds, Section 3 declares:

> It shall be unlawful for any common carrier subject to the provision of this chapter to make or give any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, or locality, or any particular description of traffic, in any respect whatsoever, or to subject any particular person, company, firm, corporation, or locality, or any particular description of traffic, to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.[65]

Section 3 makes unlawful, discriminations against *persons,* against *localities,* and against *particular kinds of traffic.* The prohibitions are not absolute, however, but are qualitfied by the words *undue* and *unreasonable.*

So far as discrimination against persons is concerned, this section in part is but a repetition of Section 2; that is, its language is broad enough to include rate discriminations against persons over the same line haul. But differences in rates constitute only one kind of discrimination. There are others less obvious but quite as injurious. It is evident that Section 3 is designed to eradicate all discriminations against persons.

One of the most common discriminatory practices which has come before the commission and the courts pertains to the dis-

[63] See Vandalia Railroad Co. v. U. S. (1915) 226 Fed. 713. This was a prosecution under the Elkins Law.

[64] Leases and Grants by Carriers to Shippers (1922) 73 I. C. C. 671.

[65] U. S. Code, Title 49, Sec. 3(1).

tribution among shippers of cars, particularly coal cars. A preference of this kind is a violation of Section 3.[66] Questions of such preference arise usually in times of car shortage. Normally, of course, a carrier is under an obligation to furnish rolling stock upon reasonable demand, but sometimes justifiably or unjustifiably it is unable to comply with a request. In order to obviate all possible preferences and in order to secure equality of treatment, the carrier is required to prorate cars according to the average quantity of coal which each mine presents for shipment.[67]

Another method of giving a preference is through the furnishing of much quicker transportation for the goods of a favored shipper. No doubt such discrimination has often existed. Although difficult to detect, it can be and has been very injurious to less favored shippers, in some instances even forcing them to cease operations.[68]

To allow one shipper any privilege or to afford him any service which is not open to other persons similarly situated is a violation of Section 3. For instance, to permit one company a *milling-in-transit privilege* and refuse it to another may constitute a violation of this section.[69] To grant switching facilities to one person and not to another in a similar position is another illustration of an illegal preference. The Supreme Court has declared that a railroad may not waive a defence to which it is entitled under a statute of limitations.[70] This is the rule because the prohibitions against unjust discriminations relate not merely to inequalities of charges and facilities but to any preferences.

As was previously mentioned, Section 3 prohibits discriminations against *localities*. The question is sometimes asked whether or not there is any such thing as a discrimination against a locality which is not at the same time a discrimination against some person or company. Probably there is not, for behind

[66] See Morrisdale Coal Co. v. Penn. Ry. Co. (1913) 230 U. S. 304, 57 L. Ed. 1494, 33 S. Ct. 938.

[67] The Assigned Car Cases (1927) 274 U. S. 564, 71 L. Ed. 1204, 47 S. Ct. 727.

[68] See the examples cited by the Interstate Commerce Commission *in re* Private Cars (1918) 50 I. C. C. 652(691).

[69] See Douglas v. C. R. I. and P. R. (1909) 16 I. C. C. 232.

[70] Phillips Co. v. Grand Trunk W. R. Co. (1915) 236 U. S. 662, 59 L. Ed. 774, 35 S. Ct. 444.

every complaint is the individual shipper. Discriminations against localities, however, are discriminations in rates or services against persons where there is a difference in the line haul of the goods. For example, a railway has two lines which are equal in length, one of which runs from C to A, and the other from B to A. If a railway charges more to carry certain commodities from C to A than from B to A, the railway may be granting an unreasonable preference. Section 3 obligates a carrier to observe a proportional relationship between the factors, cost and value of service, and the charges for each haul.[71]

The prohibitions of Section 3 are not absolute but are qualified by the terms, undue and unreasonable. As a result, certain factors sometimes justify apparent preferences between localities. The principal factor is *competition.* Competition may be of three kinds: competition of other carriers by rail, competition of other kinds of carriers (such as water carriers), and market competition. To take a concrete illustration, let us suppose the rate on a certain commodity from A to B, a distance of 50 miles, is 8 cents; whereas the rate on the same commodity from C to B, a distance of 50 miles, is 6 cents. An apparent discrimination of this kind is sometimes justified by rail or water competition which exists between C and B but which does not exist between A and B.

As was previously pointed out, Section 3 makes it unlawful to discriminate between classes of traffic. This prohibition does not prevent classification of freight and the assignment of commodities to the various classifications according to weight, bulk, liability to damage, and value. In the assignment of commodities to different classifications, however, the carrier must be careful not to discriminate against particular classes of traffic.[72] For instance, to assign brick to the first class and building stone to the fifth class would undoubtedly violate this provision. Or to assign oranges to the second class and grapefruit to the fifth class would doubtlessly violate the law. The commission will sustain

[71] See the article by Henry Hall in 51 *American Law Review* 166, which contains a good discussion of discrimination and the Interstate Commerce Act.

[72] See American Tie and Timber Co. v. K. C. S. Ry. Co. (1909) 175 Fed. 28 where the court stated, "The classification of railway cross-ties in a different class from other lumber, imposing upon them a higher rate, has been held to be unjust discrimination."

a charge of undue discrimination under this provision only if there exists a competitive relationship between the commodities in question. Such competitive relationship exists between grapefruit and oranges and between brick and building stone. In a case where there was no competitive relationship between the commodities, such as wool and leather, the commission refused to find that a difference in rates constituted a violation of Section 3.[73] In another case the commission refused to find that rates on walnuts were discriminatory as compared with the rates on certain other California food products. In handing down its decision the commission declared:

> In any event, it is well settled that discrimination under the third section to be undue and unlawful must ordinarily be such that the prejudice arising out of it against one party is a source of advantage to the other alleged to be favored, and that generally a competitive relation between the commodities must appear . . . It does not appear here that the higher rate on nuts has been a source of advantage to the shippers of other commodities, or that there is any real and substantial competitive relation between nuts and the other California products.[74]

In addition to the first paragraph of Section 3, discussed above, there are two other provisions of this section which are designed to insure equality of treatment. Section 3 specifically provides that no carrier shall deliver or relinquish freight until all rates and charges have been paid, except under such rules and regulations as the commission may prescribe.[75] To allow one shipper or receiver credit in paying transportation charges and to refuse this to others might be a very injurious method of discriminating. This section also provides that carriers shall furnish equal facilities to other carriers by rail for the interchange of traffic and that they shall not discriminate in their charges or unduly prejudice any connecting line.[76]

4. *The Long- and Short-haul Clause.* One of the well-known sections of the Interstate Commerce Act is Section 4 which contains the provision commonly referred to as the *Long- and short-haul clause.* This part of the act is designed to prohibit

[73] Boston Wool Trade Ass'n v. Director General (1923) 78 I. C. C. 341.

[74] California Walnut Growers Ass'n v. A. R. R. Co. (1918) 50 I. C. C. 558 (567).

[75] U. S. Code, Title 49, Sec. 3(2).

[76] U. S. Code, Title 49, Sec. 3(3).

special kinds of discrimination and is very limited in its application. The first part of this section provides as follows:

> It shall be unlawful for any common carrier . . . to charge or receive any greater compensation in the aggregate for the transportation of passengers, or of like kind of property, for a shorter than for a longer distance over the same line or route in the same direction, the shorter being included within the longer distance, or to charge any greater compensation as a through rate than the aggregate of the intermediate rates subject to the provisions of this chapter . . . [77]

It is important to note that in order to constitute a violation of this provision, the discrimination must pertain to carriage over the *same line* in the *same direction*. A discrimination which is not of this character may be a violation of some other part of the Interstate Commerce Act but it is not a violation of Section 4.

Section 4 has two important parts, that which states that a carrier may not charge greater compensation for a shorter than for a longer distance; and that which declares that a carrier may not charge more for the entire distance than the aggregate of intermediate rates.

The prohibitions of Section 4 are not absolute. The commission, after investigation, may grant relief from the operation of its provisions. When a carrier seeks relief the request is known as an "Application for 4th Section Relief." The question naturally arises as to the circumstances which justify a departure from the provisions of Section 4. Competition constitutes the principal justification for granting "4th Section Relief." There are three kinds of competition, any one of which may serve as a basis for granting relief, *railroad* competition, *water* or *motor* competition, and *market* competition.

However, the act prescribes that where relief is granted the charge must reasonably compensate for the service performed. Furthermore, the commission has declared that a carrier seeking a departure from this section must show that no injustice will be done to intermediate points.[78] In other words, the commission places upon the carrier the burden of proving a case for an exception to the 4th Section.

[77] U. S. Code, Title 49, Sec. 4(1).

[78] See statement of the commission, *In re* Applications for Relief Under the Fourth Section (1922) 21 I. C. C. 329.

The desire to obtain relief from the rule in the 4th Section because of railroad competition arises chiefly from a desire on the part of roads with circuitous routes to compete with roads having more direct communication between important points. It is obvious that there must be some limit to the circuity which will entitle a carrier to relief from Section 4. As a general rule, the commission has adopted a rule that relief will not be granted unless the longer route is at least 15 per cent more circuitous than the direct line.[79] The commission has objected also to the granting of relief where the route is too circuitous. No definite maximum has been fixed, although it has been indicated that the circuity should not be over 70 per cent.[80]

Although water competition is justification for "4th Section Relief," the commission may not grant such relief where there is merely potential water competition. The problem of motor competition is becoming more and more important. If water competition is justification for relief from the operation of the 4th Section, motor competition should likewise justify a departure.[81]

The third kind of competition justifying an exception to Section 4 is known as *market competition.* Certain markets are situated at unequal distances from important sources of supply and inasmuch as rates constitute such a large item in the cost of commodities, more distant regions are often unable to compete in these markets if the rule in the 4th Section is rigidly applied. For example, Chicago had three sources of supply from which it could secure cane sugar: Louisiana, California, and certain Atlantic ports. The distances were obviously unequal. In order to allow California to compete in the Chicago market for this product, the Interstate Commerce Commission granted "4th Section Relief."[82]

The precarious financial condition of a railroad has sometimes led the commission to grant relief from the rule in Section 4 even where competition has not existed. In allowing a departure for

[79] See p. 162, "Railroads" by Vanderblue and Burgess. See, however, *In re* Rates on Salt (1912) 24 I. C. C. 192(196), "We do not hold that this rule should be made one of universal application in disposing of fourth-section applications involving rates of freight."

[80] Petroleum to Southern Points (1925) 102 I. C. C. 756.

[81] Coal Rates from the Anthracite Region (1913) 28 I. C. C. 235.

[82] Rates on Sugar (1914) 31 I. C. C. 511.

this reason the commission has declared that the persons and communities should be interested in the maintenance of the line as a channel of commerce and has declared that strict compliance would endanger the carrier.[83]

5. *Filing of Rates and Charges.* Another part of the act which is designed to prevent unjust and unfair discrimination is Section 6.[84] The first part of this section requires every common carrier to file with the commission, print, and keep open to public inspection schedules showing all the rates for transportation. This provision is designed to prevent the possibility of a particularly insidious form of discrimination. If such rates are not published and accessible to all, it is easy for the carrier to grant one rate to a favored shipper and another to a less favored shipper. Secrecy provides an excellent cloak for discriminatory practices; whereas publicity and accessibility eliminate many possibilities of injustice.

Section 6 contains a number of other provisions, at least two of which demand some consideration. In the first place, no carrier is to make changes in the filed rates and charges except after 30 days' notice to the commission and to the public. However, the commission may in its discretion allow changes upon less than the 30 days' notice. In the second place, this section provides that no carrier is to demand or collect more or less or different compensation for transportation than the rates specified in the filed tariff. A number of cases have arisen under the latter provision. It has been held to be a violation of this section of the act to accept promissory notes in payment of services rendered.[85] Also, a carrier may not receive land from a shipper and pay the shipper by means of rebates on products transported.[86] It is a violation of Section 6 for a carrier to lease its

[83] Reopening of Fourth Section Application No. 3912 (1922) 73 I. C. C. 228 (232). In dissenting, in part, Commissioner Hall declared, "I cannot concur in the majority's findings to the extent that they rest upon the Tennessee Central's weak financial condition. Following that principle we could deny relief to another carrier similarly situated because it is financially strong. Varying degrees of prosperity or adversity can hardly constitute the 'special cases' of which the fourth section speaks."

[84] U. S. Code, Title 49, Sec. 6.

[85] U. S. v. Hocking Valley Ry. Co. (1911) 194 Fed. 234.

[86] See statement of the court in Fourche River Lumber Co. v. Bryant Lumber Co. (1913) 230 U. S. 316, 57 L. Ed. 1498, 33 S. Ct. 887.

land to shippers at a low rental where it appears that traffic of the lessee is part of the consideration for the lease.[87] The acceptance of advertising and the issuance of a pass to a publisher, his family, or employees is a violation of this section.[88] Likewise, it has been held illegal for a railroad to grant transportation to persons in exchange for a release from a claim for damages arising from injuries.[89] To allow payment in forms other than money would open the door to gross frauds, fabricated claims, and padded values which might indirectly result in harmful discriminations.

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[88] Chi. I. and L. Ry. Co. v. U. S. (1911) 219 U. S. 486, 55 L. Ed. 305, 31 S. Ct. 272.

[89] L. and N. R. Co. v. Mottley (1911) 219 U. S. 467, 55 L. Ed. 297, 31 S. Ct. 265.

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CHAPTER VIII

REGULATION OF MOTOR BUSSES AND TRUCKS

An adequate and integrated system of control of transportation would regulate all forms of transportation, by airplane, boat, railroad, or motor vehicles, so that each might compete with others for traffic on a somewhat equal basis. Such a plan would also seek to fit each into its proper place. Unfortunately, for a long period of time in this country we had no integrated plan of control for our transportation system. While railroads were stringently regulated by Federal and state governments, other forms of transportation which were offering the severest kind of competition were subjected to no regulation at all or only a part of their activities were controlled. Gradually the states passed legislation controlling motor busses and trucks, and in 1935 Congress enacted legislation regulating interstate motor carriers. Finally in 1938 Congress passed a law regulating transportation by airplane. Although we have made a considerable start toward an integrated system of control, there are still many inequalities and omissions due in part to constitutional difficulties and in part to the failure of legislators to enact adequate legislation.

I. State Regulation.

State laws on the subject of motor carrier control present much variation. On the whole, the regulation is not so stringent as that which pertains to railroads, nor does it emphasize the same features. In the regulation of railroads, control of rates and discrimination play an important part. In the regulation of motor carriers these are less important, and the issuance of certificates of convenience and necessity, the requirements for bonds or insurance to indemnify persons for loss or injury, and the prescriptions for safety devices and equipment receive more attention from the regulatory authorities.

For purposes of discussion the subject of motor bus and truck regulation has been classified under the following topics: (1) kinds of vehicles regulated, (2) certificates of convenience and necessity, (3) rates and service, (4) bonds and indemnity insurance, and (5) other kinds of control.

1. *Kinds of Motor Carriers Regulated.* The first state laws regulating motor carriers pertained to passenger vehicles. Such legislation became imperative because of the sudden appearance of the jitney bus as an instrument of transportation. Almost overnight hundreds of persons who thought they foresaw opportunities to make money purchased new or old automobiles or turned their pleasure vehicles into common carriers and offered to take persons almost anywhere for any price. At first their activities were confined largely to transportation within city limits, but gradually they extended their services to routes between towns. These swarms of jitney busses which flooded the streets and highways were a distinct menace. They threatened the existence of established and more reliable forms of transportation; they were financially irresponsible and often could not compensate passengers who were injured; frequently they maintained no definite time schedules or uniform fares; and as a rule they gave no assurance that their service would be continued. State and local authorities met the situation by enacting legislation to regulate motor busses. The first hasty efforts at control were followed by more comprehensive legislative programs.

Motor transportation of freight was also developing. At first it was conducted on more or less irregular schedules but gradually it developed into carriage over definite routes and between fixed termini. States have been slower to bring under control the transportation of common carriers of freight by trucks. By force of circumstances, however, they have gradually been compelled to do so.

One of the difficult problems with which states have been confronted is the regulation of motor carriers other than common carriers. A common carrier has been defined as one which holds itself out to serve all to the limit of its capacity. But other types of carriers, private and contract, have made their appearance. A private carrier has been defined as any person who is engaged in the transportation of property sold or to be sold by him in the furtherance of any private commercial enterprise. A contract

carrier has been defined as any person who is engaged in the transportation for hire under special agreement.[1]

At first, some of the states attempted to control all carriers under the same regulatory statutes by defining as subject to the jurisdiction of the commission anyone engaged in the transportation of persons or property for hire over the highways.[2] The Supreme Court held, however, that such legislation violated the "due process clause" of the Fourteenth Amendment because it converted all carriers into common carriers by subjecting them to all of the liabilities and restrictions of common carriers.[3]

It was perhaps unfortunate that the Supreme Court declared certain state regulations of private and contract carriers unconstitutional. The effect of the Supreme Court decision was to create confusion and uncertainty. Persons have been tempted to resort to various devices, particularly the making of contracts with shippers, to place themselves outside of the category of common carriers and thus escape unwanted regulations. Such attempts have sometimes been successful. On the whole, however, courts have shown a commendable willingness to look to the realities of the situation and have held that the mere making of many contracts does not make a person a private carrier where in fact the person is offering his services to anyone who will sign a contract and thus by a subterfuge is seeking to evade control.

Even though state legislatures may not constitutionally convert all carriers into common carriers, they may subject both private and contract carriers to certain regulations.[4] In order to avoid the taint of unconstitutionality, state statutes usually separate the regulations of common carriers from those of other types of carriers. For example, the Wisconsin statute distinguishes three classes of carriers: common, contract, and private; and it makes different regulations for each.[5] An Oregon law defines four kinds

[1] Laws of Oregon, 1933, Chap. 429, Sec. 1.

[2] Acts of California, 1919, Chap. 280, Sec. 2.

[3] Frost v. Railroad Com. (1926) 271 U. S. 583, 70 L. Ed. 1101, 46 S. Ct. 605.

[4] Stephenson v. Binford (1932) 287 U. S. 251, 77 L. Ed. 288, 53 S. Ct. 181; Continental Baking Co. v. Woodring (1932) 286 U. S. 352, 76 L. Ed. 1155, 52 S. Ct. 595.

[5] Wisconsin Code 194.01(11).

of carriers: common, contract, special, and private.[6] Indiana has enacted a separate statute for contract carriers.[7]

In the case of private carriers it is unnecessary to have regulations as drastic or of the same character as those pertaining to common carriers, or even those for contract carriers. Regulations of rates and services are obviously unnecessary. Likewise, it is not necessary to require a high degree of care in the transportation of goods or persons. On the other hand, limitations on the weight or length of vehicles are as important here as they are in the case of either contract or common carriers, and states have frequently imposed such restrictions. Also, states have sometimes required permits to operate as private carriers.[8]

The constitutional justification for the regulation of contract carriers may be found in two sources, (1) proper control of the highways, and (2) the need of protecting the regulated common carriers from unfair and destructive competition. Although courts have placed much emphasis upon the necessity of protecting the highways, many of the regulations imposed upon contract carriers appear to be regulations of businesses affected with a public interest and as such seem to be intended to protect common carriers from unfair competition. Regardless of the reasons for control or the source of regulative power, the regulations must be reasonable and commensurate with the abuses which the state is seeking to correct or to prevent.

Although the states may not convert contract carriers into common carriers, they may subject them to many of the restrictions imposed upon common carriers. The most usual type of regulation imposed upon contract carriers is a requirement that persons wishing to commence operation must obtain a permit, granted, as a rule, after a finding of public convenience and necessity. Courts have almost invariably upheld this requirement.[9] Other regulations imposed upon contract carriers by the states have been upheld, such as the control of rates and services and the requirement of filing reports and keeping uniform

[6] Laws of Oregon, 1933, Chap. 429, Sec. 1.

[7] Acts of the General Assembly of Indiana, 1933, Chap. 70.

[8] Laws of Wyoming, 1937, Chap. 121, Sec. 9.

[9] Commonwealth v. Reardon (1933) 185 N. E. 40, 282 Mass. 345; Barney v. Board of Railroad Commissioners (1932) 17 P. 2d 82, 93 Mont. 115.

accounts.[10] Regulations have even been upheld which forbid contract carriers to give unreasonable preferences to their patrons as compared with the facilities and rates offered to patrons of common carriers.[11] Certainly this latter type of regulation is in no way intended to protect the highways but is designed to protect common carriers from unfair competition.

2. *Certificates of Convenience and Necessity.* One of the prevalent features of the control of motor carriers is the limitation of the number of those who may engage in such service through the issuance of certificates of convenience and necessity. Nearly every state has legislation of this sort, varying in detail but providing in general that no person may commence operation without securing a permit from the commission and stating that such permit shall be issued by the commission only in case the public convenience and necessity require the proposed service.[12]

To control entrance into service is more important in the case of motor carriers than in the case of other kinds of utilities. The original cost of motor equipment is not heavy in comparison with the cost of a gas or telephone plant. Nor is the cost of operation heavy since the state in constructing and maintaining the roadbed furnishes a large part of the equipment. Without some method of control, however, streets and highways would soon become congested with numerous irresponsible carriers, much to the detriment not only of established motor carriers but also of railroads and street railways. Likewise, the public has an interest in preventing extensive duplication of facilities. Too many busses and trucks result in the rapid destruction of the highways and constitute a menace to the safety of those who wish to travel on public thoroughfares. Furthermore, if carriers are to be subjected to regulation of rates and services, it is but equitable that they should be protected from unlimited competition.

The use of the certificate of convenience and necessity substitutes regulated monopoly for cutthroat competition. Of course, if the limitation on competition is to be successful, all phases of regulation—rates, services, and safety devices—must

[10] McEntyre v. Ga. Pub. Ser. Com. (1933) 168 S. E. 246, 176 Ga. 398; Schwartzman Service Co. v. Stahl (1932) 60 Fed. 2d 1034; Anderson v. Thomas (1933) 26 P. 2d 60, 144 Ore. 572.

[11] Baker v. Glenn (1933) 2 Fed. Supp. 880.

[12] See, for example, Vernon's Texas Statutes, 1936, Art. 911b, Sec. 9.

be effective. Unfortunately, in the case of public utilities that has not always been the situation. All too often, public service companies have been granted monopolistic privileges but have not been subjected to stringent control.

The exact nature of certificates of convenience and necessity is difficult to determine. It has been held that they do not confer property rights, nor are they franchises or contracts.[13] They are not assets in the nature of good will for, as one court has said, a certificate is granted because the public is ready and willing to be served.[14] At best, a certificate seems to be little more than a revocable license to serve the public for a limited period of time.

In some states elaborate statutory provisions are to be found outlining the procedure to be followed in applying for and issuing certificates of convenience and necessity. For example, in Ohio the application must be made in writing, must show the principal office and residence of the operator, must contain full information concerning the physical property to be used by the applicant, must provide a map and a description of the proposed route, and must show the proposed time schedule and tariff. Public notice in a newspaper must be given of the proposed operations and a hearing held thereon.[15]

In determining whether or not to issue a certificate to an applicant, the important factor which commissions must consider is public convenience and necessity, that is, the need of the public for the proposed service. Many and varied are the attempts to reduce this indefinite expression, public convenience and necessity, to more definite terminology. Apparently the convenience and necessity which justifies the issuance of a certificate is that of the whole public. That a service may benefit a small group is not regarded as sufficient basis for granting a certificate. Furthermore, the words, convenience and necessity, are not separable but must be construed together; that is, to obtain a certificate the applicant need not show indispensable necessity nor is it enough for him to prove mere convenience.[16]

[13] Schieble v. Hogan (1925) 148 N. E. 581, 113 Oh. St. 83; *In re* Western Motor Transport Co., P. U. R. 1922 C 12 (Cal.).

[14] Penn. R. Co. v. Pub. Util. Com. (1927) 155 N. E. 694, 116 Oh. St. 80.

[15] Ohio Code, Secs. 614–90 and 614–91.

[16] *In re* McCartney, P. U. R. 1928 C 183 (Mo.); *In re* Summer Tacoma Storage Co., P. U. R. 1924 E 303 (Wash.).

By far the largest number of cases which arise before commissions presents the question of whether or not to allow additional carriers to enter a field already occupied by one or more operators. According to the general rule a commission will not allow a carrier to enter territory already served.

To this rule there are exceptions, all of which are based upon a finding that the public convenience and necessity will be served by the entrance of an additional carrier. One reason for allowing competition is that the existing company is giving inadequate and unsatisfactory service. A second circumstance under which a commission will permit a motor carrier to enter an occupied field is when the petitioner is intending to give a new kind of service. For example, an applicant who offered parlor-motor cars, meals, and hotel accommodations was granted a certificate because the proposed service was essentially different from any which existed on the routes to be served.[17] Likewise, motor service which was designed to transport freight of more than 200 pounds was enough different from existing service to warrant the issuance of a certificate.[18]

One of the difficult questions which commissions have been called upon to decide is whether or not to approve the application of motor carriers for certificates to operate in a territory already occupied by railroads or street railways. It is true that motor service offers certain differences which are advantageous to the public. Busses pick up and discharge passengers at almost any point. Freight service is advantageous in that it is unnecessary to box and crate, it requires no billing, it is easy to trace lost articles, and it offers "pickup" and delivery of articles from door to door. Are these advantages sufficient to outweigh the disadvantages which must arise from excessive competition between railroads and motor carriers? After all, it is the convenience and necessity of the whole public and not a small group which must be considered. Not only the convenience and necessity of the moment but also that over a long period of time must be considered.

The disastrous consequences of unlimited motor competition are obvious. The result may be financial ruin for railroads or

[17] *In re* Boyd, P. U. R. 1925 A 715 (Cal.).

[18] *In re* Philadelphia Trenton and Chester Co., P. U. R. 1927 B 604 (Penn.).

street railways. So long as these utilities have important functions to perform, public convenience and necessity demand that they shall be protected. Public convenience and necessity are better served by strong, efficient railroad systems than by "pickup" and delivery motor service which benefits a limited number of shippers.

However, public service commissions should not favor any particular kind of utility established or unestablished. It is not their function to stand in the way of progress or to prevent the public from enjoying the advantages of new investments and improvements. If railroads and street railways are obsolete systems of transportation, they are not entitled to protection. But commissions must proceed cautiously and not allow these forms of transportation to be destroyed only to discover later that the substitutes are less desirable. The important questions in determining whether or not unlimited competition should be allowed are: Can and will the new utility supplant the old completely, that is, will motor trucks serve all the territory served by railroads? Will the motor truck carrier transport all classes of goods now carried by rail? Will the motor carrier operate under all kinds of weather conditions and at all seasons of the year? Will its service be as rapid, efficient, complete, and reasonable as that of a railroad? If the answer to these questions is yes, then there is no reason why commissions should protect railroads from competition any more than they might have protected canal boats from railroad competition in the past. At present, however, motor carriers are not in a position to supplant rail operators. Since this is the case, motor service should be supplementary to rail service as it has important functions to perform in serving territory unserved by rail or served inadequately. This is the rule now generally followed by commissions.

A few other factors in addition to the convenience and necessity of the public are sometimes considered. One of these is the effect upon the highways. Another is the financial ability of the operator. Another is the question of whether or not the venture will prove profitable.

The statutes of many states contain a provision that the commission may issue a certificate either as requested or for the partial exercise of the privilege sought and may attach such terms

and conditions as in its judgment the convenience and necessity of the public requires.[19] To allow the commission to issue a certificate for the partial exercise of the privilege sought enables it to fit the certificate more nearly to the exact needs of the public. Furthermore, to give the commission the authority to attach conditions broadens the regulatory power and enables the commission to fit the conditions to each individual case.

The rule that certificates of convenience and necessity cannot be transferred without the consent of the commission is well established.[20] It matters not whether the attempted transfer is by operation of the law or by the act of the parties.[21] Two purposes appear in this requirement. In the first place, it is a means of checking indiscriminate speculation and trafficking in certificates, a practice which commissions quite generally deprecate. In the second place, it is a method of protecting the public against the transfer of certificates to persons who might give an inferior quality of service, since the commission in passing upon the application for transfer may consider the reliability of the transferree and the quality of service which he is likely to provide.

Quite frequently statutes contain provisions permitting commissions to revoke, alter, or suspend the operating privileges granted under certificates of convenience and necessity.[22] Sometimes the statutes say that this may be done for good cause, which usually means for violating the statutes or rules of the commission.[23] The Louisiana Commission went farther and in one case revoked a certificate because the holder had been giving poor service.[24]

3. *Rates and Service.* Motor carriers like other utilities are under the obligation to give adequate service at reasonable rates. The statutes of many states give to their commissions some authority to enforce these obligations.

[19] See, for example, Laws of Minnesota, 1925, Chap. 185, Sec. 8.

[20] "Certificates of Convenience and Necessity" by Ford P. Hall, 28 *Michigan Law Review* 304.

[21] Estabrook v. Public Util. Com. (1925) 147 N. E. 761, 112 Oh. St. 417; Red Ball Transit Co. v. Public Util. Com. (1925) 147 N. E. 762, 112 Oh. 462.

[22] See, for example, Ohio General Code, Secs. 614–87.

[23] *In re* Bill's Sightseeing Co., P. U. R. 1928 A 775 (Colo.).

[24] *Ex Parte* Vincent, P. U. R. 1928 C 178 (La.).

In many states one finds only a general statement giving the commission the power to fix rates.[25] Sometimes the power of the commission is confined to fixing maximum rates. In Minnesota the statute states that the commission shall take into account, among other things, the kind and character of the service to be performed and the effect of rates upon other common carriers so as to avoid, if possible, unreasonable competition.[26]

Despite the control over rates of motor carriers which legislatures have conferred upon public service commissions, few general principles have been worked out. This is due in part to the fact that much of the legislation is quite recent. It is due also in part to the chaotic condition in which commissions have found the motor industry, especially that of motor carriers of freight. The great number of such carriers and the variations in their methods of setting rates has caused much difficulty. The Wisconsin Commission in investigating rates found that some of the carriers had charged a flat rate for all commodities regardless of differences in bulk, value, or liability to damage. Others classified goods and charged accordingly. Others had specific commodity rates. Some had rates per cubic foot. Others had point-to-point rates.[27] This commission confessed that there was no established yardstick by which motor freight rates could be measured. The difficulty arises because of the endless variety of circumstances and conditions. What is peculiar to one motor transportation company would not apply to another. One truck company, favorably located, might prosper under a certain scale of rates and another not so favorably situated might suffer. The Wisconsin Commission finally ordered the use of railroad rates as a basis for the shipment of freight by motor carriers.[28] The Maryland Commission used a zoning basis in fixing rates for hauling milk to Baltimore.[29] There seem to be two schools of thought

[25] Public Acts of Tennessee, 1929, Chap. 58; Laws of Wyoming, 1937, Chap. 121, Sec. 5; Laws of Oregon, 1933, Chap. 429, Sec. 6(1); Vernon's Texas Statutes, 1936, Art. 911b, Sec. 4(a); Acts of Arkansas, 1929, Act No. 62, Sec. 4.

[26] Minnesota Laws of 1925, Chap. 185, Sec. 4.

[27] See the statement of the Commission *In re* Auto Transportation Companies, P. U. R. 1930 C 54 (Wis.).

[28] *In re* Auto Transportation Companies, P. U. R. 1930 C 54 (Wis.).

[29] *In re* Rates of Motor Vehicle Operators Transporting Milk, P. U. R. 1930 E 249 (Md.).

concerning the basis for fixing motor freight rates. Some prefer to use railroad rates as a model, while others wish to establish simplified rates and classifications based primarily on trucking conditions and costs.[30]

Theoretically, rates for motor carriers as a whole should be fixed at a level which would enable them to earn a fair return upon the value of their property over and above reasonable operating expenses. To arrive at a just level of rates under such circumstances would necessitate the selection of a rate base and entail a valuation of the property. In actual practice, however, the valuation of motor carriers has as yet played little part in fixing rates. Such terms as cost of reproduction, going value, working capital, and depreciation—terms which are familiar in fixing rates for railroads and public utilities—have had little application in determining rates for motor carriers.[31] The ascertainment of the valuation of an individual motor carrier should not be as difficult a task as the making of a valuation of railroad or telephone properties. The problem in the case of motor carriers arises from the existence of a large number of operators and the difficulty of establishing uniform rates which are just and fair to all.

The statutes of many states give to commissions a general authority to regulate the service of motor carriers under their jurisdiction.[32] Under such general provisions commissions have adopted rules and regulations requiring the filing and posting of time schedules for the convenience of the public, prohibiting the carriage of passengers in excess of the seating capacity, ordering the maintenance of vehicles in a safe and sanitary condition, requiring the establishment of stations, and ordering the heating and lighting of passenger buses.[33]

Abandonment of service without the consent of a public service commission is sometimes provided for by statute and sometimes by rule of the commission.[34]

[30] See statement in the Annual Report of the Interstate Commerce Commission 1936, p. 73.

[31] See, however, *In re* Rates of Motor Vehicle Operators Transporting Milk, P. U. R. 1930 E 249 (Md.).

[32] See Vernon's Texas Statutes, 1936, Art. 911b, Sec. 4(a).

[33] Motor Bus Rules and Regulations of the Texas Railroad Commission; Rules and Regulations of the Public Utilities Commission of Colorado Governing Motor Vehicle Carriers.

[34] See Laws of Missouri, 1927, p. 405, Sec. 5; Laws of Minnesota, 1925, Chap. 185, Sec. 4.

4. *Insurance and Bonds.* Common carriers are responsible for the safe carriage of persons or commodities. To this rule there are exceptions, for instance, an Act of God.[35] Because of the somewhat hazardous character of motor vehicle operations and the financial irresponsibility of many operators, states have quite frequently made regulations concerning insurance and bonds. Such laws require that before or at the time of granting a certificate of convenience and necessity, a company which is proposing to operate shall file with the commission a surety bond or insurance policy for the protection of passengers and property against loss or injury resulting from the operations of the carrier.[36] Sometimes such insurance policies or surety bonds are required to have attached to or set forth in the policies certain provisions designated by statute or rules of the commission.[37] The amount of the bond or insurance usually varies with the number of cars operated or the seating capacity of the vehicles.[38]

5. *Other Kinds of Regulations.* In addition to the regulations which have been discussed in the preceding pages, some states impose a few other regulations upon motor carriers. Commissions in some states are given control over the issuance of stocks and bonds.[39] Commissions in several states have authority to require reports and to prescribe and inspect accounts. Limitations upon the length, width, and maximum loads of busses and trucks are not uncommon.[40] Commissions often prescribe the use of emergency doors in the rear of busses, demand the maintenance of proper brakes, require busses to stop at railroad crossings, and insist that they take other precautions which make highway travel less hazardous.

II. Federal Regulation.

Even though much progress had been made by 1935 in state regulation of motor busses and trucks, the situation was still

[35] "Principles of Motor Transportation" by Ford K. Edwards.

[36] Acts of Arkansas, 1929, Act 62, Sec. 3(e); Laws of Missouri, 1927, p. 407, Sec. 7; Laws of Minnesota, 1925, Chap. 185, Sec. 11.

[37] See Rules and Regulations of the Nebraska Commission Governing Motor Transportation Companies, Rule 8, P. U. R. 1927 E 493.

[38] See *In re* Liability Insurance for Taxicabs, P. U. R. 1929 D 561 (Neb.).

[39] Deering's General Laws of California, 1931, Act 5129, Sec. 6.

[40] Vernon's Texas Statutes, 1936, Art. 6675–6686.

chaotic because of the lack of Federal legislation.[41] If busses or trucks were engaged only in interstate commerce, the courts had held that certain kinds of state regulations were unconstitutional. For example, a statute of the State of Washington attempted to require certificates of convenience and necessity of busses which proposed to operate in interstate commerce. The Supreme Court of the United States held that this law was invalid because it violated the "commerce clause" of the Constitution.[42] As a result, many persons operating motor carriers who wished to escape state control confined their operations to interstate commerce. It was not uncommon to find a motor bus operating between two states which would take on passengers in one state but refuse to allow them to leave the bus before crossing the state line. In this way the bus was immune from state regulation because it was operating only in interstate commerce.

Finally, Congress passed the Federal Motor Carrier Act of 1935, placing motor carriers under the jurisdiction of the Interstate Commerce Commission. The Federal Motor Carrier Act has some features similar to the provisions of state laws regulating this industry and others similar to certain provisions of the Interstate Commerce Act regulating railroads. Despite the fact that this act is a tremendous step in the direction of Federal control of motor transportation, the law does not go so far in controlling these carriers as does the Interstate Commerce Act in regulating railroads. It probably would have been unwise and impracticable to have attempted more extensive legislation in 1935. As soon as the public and the motor industry have become adjusted to the present provisions, additional regulatory measures can be passed if needed. In fairness to the railroads, which are drastically controlled, additional legislation should be adopted in order to place these two competing forms of transportation on an equal basis.

The purpose of the Federal Motor Carrier Act of 1935, as set forth in the opening paragraphs, is to regulate motor transportation so as to preserve its inherent advantages, to foster sound economic conditions in this type of transportation, to promote

[41] See "The Federal Motor Carrier Act of 1935" by John J. George, 21 *Cornell Law Quarterly* 249, February, 1936.

[42] Buck v. Kuykendall (1925) 267 U. S. 307, 69 L. Ed. 623, 45 S. Ct. 324.

adequate, efficient, economical, and nondiscriminatory motor service at reasonable rates, to coordinate motor carrier service with other forms of transportation, and to cooperate with the states and motor carrier organizations in the application of the act.[43]

In order to effectuate this purpose, the act provides varying kinds and degrees of regulation for common carriers, contract carriers, private carriers, and transportation brokers. The definitions of the terms, common carrier, contract carrier, and private carrier, are similar to those which are found in some of the recent state statutes. The term, broker, is defined as a person other than a common or contract carrier who sells or arranges for transportation.

1. *Certificates, Permits, Licenses.* As might be expected, one of the important types of control imposed upon motor carriers is a requirement that they must obtain permission to operate from the Interstate Commerce Commission. The kind of permission which is required varies with the type of motor carrier. Common carriers must secure a certificate of convenience and necessity. Contract carriers must obtain a *permit* which is to be issued by the commission after a finding that the proposed operation will be consistent with the public interest and the purpose and policy set forth in the beginning of the act. The so-called travel or transportation broker must obtain a *broker's license* which is to be issued if the commission finds that the proposed service will be consistent with the public interest and the policy of the act.[44] Certificates, permits, and licenses are issued for an indeterminate period of time.

On the date of the passage of the Motor Carrier Act there were thousands of individuals and companies engaged in furnishing motor carrier service between states. Congress provided that common and contract carriers and transportation brokers should be entitled to certificates, permits, or licenses if they were operating before certain dates fixed in the statute. Such persons, however, were required to make application to the commission in order to secure the necessary permission to operate. Some idea of the magnitude of the task which confronted the Interstate

[43] Public Act No. 255, 74th Congress, Sec. 202a.

[44] Public Act No. 255, 74th Congress, Secs. 206, 209, 211, and 212.

Commerce Commission in issuing certificates and permits can be gathered from the fact that by 1937 nearly 90,000 requests had been received.[45]

2. *Acquisition of Control and Issuance of Securities.* Under the provisions of the Motor Carrier Act common carriers or contract carriers wishing to consolidate, merge, purchase or lease property, or acquire stock of other motor carriers must secure the approval of the Interstate Commerce Commission. Approval is also necessary when a person other than a motor carrier is the party seeking to acquire control. Upon application the Interstate Commerce Commission is to set a time and place for a public hearing and to notify the governor of each state in which any part of the property is situated or is operated and to notify also all other parties having any substantial interest. If the commission finds that the proposed combination is consistent with public interest, it may enter an order of approval.[46]

The Motor Carrier Act imposes upon common and contract carriers the same regulations with regard to the issuance of stocks and bonds as are imposed upon railroads under Section 20a of the Interstate Commerce Act. These requirements do not apply to motor carriers desiring to issue securities where the securities to be issued together with the securities outstanding do not exceed $500,000.[47]

3. *Rates, Discrimination, Accounts.* The Federal Motor Carrier Act confers some rate control upon the Interstate Commerce Commission, although such control is not as extensive as that over carriers by rail.[48]

It is the duty of every common carrier to establish just and reasonable individual and joint rates. All rates must be filed with the commission and kept open to the public.[49] The commission is given the power to fix rates after a hearing on a complaint or after an investigation on its own initiative. The commission may fix the maximum, minimum, or absolute rate.[50]

[45] Annual Report of the Interstate Commerce Commission, 1937, p. 71.

[46] Public Act No. 255, 74th Congress, Sec. 213.

[47] Public Act No. 255, 74th Congress, Sec. 214.

[48] See "The Federal Motor Carrier Act of 1935" by John J. George, 21 *Cornell Law Quarterly* 267, February, 1936.

[49] See Tariff Circular MF No. 2 and Tariff Circular MP No. 3, which govern the filing of freight and passenger rates.

[50] Public Act No. 255, 74th Congress, Secs. 216 and 217.

The act provides for less power to regulate the rates of contract motor carriers. Contract carriers merely file and publish their minimum rates. Upon complaint or after investigation on its own initiative, if the commission finds that a rate contravenes the policy declared in the first part of the act, it may prescribe a minimum charge.[51]

The law declares that it is unlawful for a common carrier to give any undue or unreasonable preference to any person, locality, or kind of traffic and gives the commission the power to remove such discrimination.[52]

The Interstate Commerce Commission has been given authority to require annual or other reports from common and contract carriers and to prescribe the forms of accounts and other records which they shall keep.[53]

4. *Insurance and Bonds.* Because of the financial limitations of many motor carriers and the somewhat hazardous character of their operations, legislative bodies have frequently sought to protect the traveling and shipping public against loss or damage by requiring evidence that motor carriers have secured bonds or insurance. In this respect the Federal Motor Carrier Act is similar to many state laws. No certificate or permit may be issued to a motor carrier unless the carrier complies with such reasonable rules and regulations as the commission prescribes governing the filing of surety bonds, policies of insurance, or satisfactory evidence of financial ability to provide self-insurance.[54] In accordance with the statutory provisions, the Interstate Commerce Commission has established the minimum limits of insurance policies or bonds and has prescribed a form of endorsement to be attached to every policy. This endorsement contains all of the provisions required by the rules of the commission.[55]

5. *Safety.* In conclusion, it should be noted that the commission has been given the power to make reasonable requirements to promote the safe operation of vehicles on the highways by fixing qualifications and maximum hours of service for employ-

[51] Public Act No. 255, 74th Congress, Sec. 218.

[52] Public Act No. 255, 74th Congress, Sec. 216(d).

[53] Public Act No. 255, 74th Congress, Sec. 220.

[54] Public Act No. 255, 74th Congress, Sec. 215.

[55] Annual Report of the Interstate Commerce Commission, 1936, p. 72.

ees and by prescribing standards for equipment. This provision applies not only to common and contract carriers but also to private carriers.[56]

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CHAPTER IX

THE REGULATION AND PROMOTION OF AVIATION

The relationship of government to aviation presents a threefold problem. As a comparatively new industry and one which seems to hold interesting possibilities for furthering social and economic welfare, it is desirable for the government to foster and aid those who are pioneering and seeking to advance aircraft as important instruments of transportation. At the same time, as an especially hazardous kind of transportation, numerous police regulations are essential to protect the safety of the public. Furthermore, as an important medium of commercial transportation, aviation should be fitted into a properly coordinated scheme of regulation. If rates, services, and other phases of the business of other carriers are subject to control, airplanes should be similarly regulated.

Before 1926 the United States had no unified program for regulating or promoting traffic by air. In 1926, however, the Air Commerce Act was passed.[1] The Air Commerce Act did not attempt to establish a comprehensive and complete scheme of regulation for air navigation. It provided, however, for the promotion of aviation and for the establishment of a system of licensing and a code of traffic rules. No attempt was made to regulate rates or services of interstate airplane carriers. In 1938 the Civil Aeronautics Act was passed regulating rates and services of carriers by airplane. Many of the states have legislation which is designed to encourage and aid aviation and to promote the safety of this kind of transportation. There has been little occasion, however, for the states to regulate airplanes as common carriers, for most of the commercial transportation is interstate in character.

The Act of 1938 establishes an agency known as the Civil Aeronautics Authority composed of five members and authorizes this body to carry out the regulatory provisions of the act. The act also provides for an administrator who is to carry out

[1] 44 Stat. L. 568.

those provisions of the act which are designed to foster the development of and to aid air commerce.[2]

I. Federal Safety Regulations.

The important duties of the Civil Aeronautics Authority which are intended to promote the safety of air traffic can be divided into three groups. The first group includes the examination of airplane equipment and the issuance of certificates to persons whose equipment is found to be satisfactory. The second group includes the examination and licensing of pilots and mechanics. The third group includes the issuance and enforcement of traffic rules for aircraft operations.

With regard to the first of these groups of duties, the Civil Aeronautics Act gives to the authority the power to issue many kinds of certificates. For one thing, it may issue what are called *type certificates* for aircraft, aircraft engines, and aircraft propellers. Upon application and after examination if the authority finds that an aircraft, an engine, or a propeller is of proper design, material, or construction, it issues a *type certificate.*[3]

The law also permits the authority to issue *production certificates.* The *production certificate* allows a person to make duplicates of any aircraft, engine, or propeller which has been approved.[4] Obviously a *production certificate* is of importance chiefly to manufacturers of airplanes and airplane parts.

Another kind of certificate which may be issued by the authority is the *airworthiness certificate.* The owner of any aircraft may file with the authority an application for an *airworthiness certificate* for his aircraft. The authority is to issue the certificate if it finds that the aircraft conforms to a *type certificate* and if it finds after inspection that it is in condition for safe operation.[5]

The authority is also empowered to issue *air carrier operating certificates* after an investigation and a finding that the person making application is properly and adequately equipped and able to conduct safe operations in accordance with the requirements of the act and the rules and regulations of the authority.[6]

[2] Public Act No. 706, 75th Congress, 3d Session, Sec. 201.
[3] Public Act No. 706, 75th Congress, 3d Session, Sec. 603(a).
[4] Public Act No. 706, 75th Congress, 3d Session, Sec. 603(b).
[5] Public Act No. 706, 75th Congress, 3d Session, Sec. 603(c).
[6] Public Act No. 706, 75th Congress, 3d Session, Sec. 604.

No person may operate in air commerce without an *airworthiness certificate* and an *air carrier operating certificate*.[7] The term air commerce is defined by the act as interstate, overseas, or foreign air commerce.[8]

After investigation and upon notice and hearing the authority may amend or suspend any certificate if the interest of the public so requires. Likewise the authority may revoke a certificate for any cause which would justify the authority in refusing to issue a certificate.[9]

As has been previously pointed out, a second group of regulatory powers and duties of the Civil Aeronautics Authority which are intended to promote safety in air operations pertain to the fixing of qualifications, the examination of applicants, and the granting of so-called *airman certificates* to persons who successfully meet the qualifications and pass the examinations for such. These certificates may contain such terms, conditions, and limitations as to duration, periodic examinations, physical fitness, and other matters as the authority determines to be necessary in order to assure safety in air commerce.[10] The Civil Air Regulations (these are the rules and regulations promulgated by the authority) prescribe many qualifications for persons who wish to serve as airmen. Minimum age requirements, physical qualifications, and requirements for aeronautical skill, aeronautical knowledge, and aeronautical experience are fixed by these regulations. Many different classes of *airman certificates* are issued. Some of these are certificates for persons who wish to act as mechanics. Others are certificates for various classes of pilots, such as student pilots, solo pilots, private pilots, and commercial pilots.[11] It is unlawful for any person to serve in any capacity as an airman in connection with any civil aircraft used in air commerce without an *airman certificate*.[12] The law also makes provision for the revocation of these certificates.[13]

The third group of regulatory powers and duties of the Civil Aeronautics authority which pertain to safety is the establish-

[7] Public Act No. 706, 75th Congress, 3d Session, Sec. 610.
[8] Public Act No. 706, 75th Congress, 3d Session, Sec. 1(3).
[9] Public Act No. 706, 75th Congress, 3d Session, Sec. 609.
[10] Public Act No. 706, 75th Congress, 3d Session, Sec. 602.
[11] Civil Air Regulations, Secs. 20.00 to 20.67 and Secs. 24.00 to 24.40.
[12] Public Act No. 706, 75th Congress, 3d Session, Sec. 610.
[13] Public Act No. 706, 75th Congress, 3d Session, Sec. 609.

ment of air traffic rules. The act provides that the authority is empowered to prescribe air traffic rules governing the flight and identification of aircraft, including rules as to the safe altitudes of flights and for the prevention of collisions between aircraft.[14] It is unlawful for any person to operate in air commerce in violation of any rule or regulation of the authority.[15]

The Civil Air Regulations contain many air traffic rules which affect navigation by aircraft.[16] Some of these prescribe minimum safe altitudes for flight. Over cities, towns, or settlements a minimum altitude of 1,000 feet is required and over other areas a minimum of 500 feet is prescribed. Some of the rules govern the landing, take-off, and passing of aircraft. Others regulate acrobatic flights. Still others prescribe the signals and lights which must be used by aircraft.[17]

II. Economic Regulation by the Federal Government.

The Air Commerce Act of 1926 provided for safety regulations but made no attempt to regulate air transportation as a business affected with a public interest. The Civil Aeronautics Act of 1938, however, imposes a few regulations upon carriers by airplane similar to some of the regulations imposed upon railroads, motor buses, and motor trucks with which they are in competition.

No air carrier may engage in any air transportation unless it has a certificate of convenience and necessity issued by the authority.[18] The authority is to issue a certificate upon application if it finds that the applicant is fit, willing, and able to perform such transportation properly and if the public convenience and necessity requires the service. The authority may modify, suspend, or revoke a certificate after notice and hearing if the public convenience and necessity so require. No certificate may

[14] Public Act No. 706, 75th Congress, 3d Session, Sec. 601(7).

[15] Public Act No. 706, 75th Congress, 3d Session, Sec. 610(5).

[16] Most of the air traffic rules and regulations were adopted before the creation of the Civil Aeronautics Authority in 1938. In August, 1938 the Civil Aeronautics Authority adopted these rules and regulations. See *Federal Register*, Aug. 23, 1938, p. 2052.

[17] Civil Air Regulations, Secs. 60.00 to 60.93. These are reported in the *Federal Register*, Mar. 9, 1938, p. 1.

[18] The term "air carrier" means any person who undertakes either directly or indirectly to engage in air transportation, Public Act No. 706, 75th Congress, 3d Session, Sec. 1.

be transferred without approval of the authority. No air carrier may abandon any route for which a certificate has been issued unless the authority finds that such abandonment is in the public interest.[19]

Every air carrier shall file with the authority, print, and keep open to public inspection all rates for air transportation between points served by it. It is the duty of every air carrier to establish just and reasonable rates and to provide safe and adequate service. No air carrier shall give any undue or unreasonable preference to any person, locality, or description of traffic.[20] The act, however, apparently gives to the authority no power to fix rates, to prescribe service, or to remove any preference or discrimination.

The authority is empowered to require reports from any air carrier. Likewise it may prescribe the form of any accounts and have access to all accounts and records of such carriers.[21]

It is unlawful without the approval of the authority for any air carriers engaged in aeronautics to consolidate or merge their properties. Furthermore, every air carrier shall file with the authority all agreements for pooling. The authority is to disapprove any consolidation, merger, or pooling agreement if it finds that it is contrary to public interest.[22]

III. Federal Promotion of and Aid to Air Navigation.

Even before the Act of 1938 the Federal government was giving much aid to and fostering the development of air navigation. The Federal government aided in the selection, establishment, and development of airports and emergency landing fields. By an elaborate system of marks and beacon lights it sought to eliminate some of the hazards of aviation. The Federal Communications Commission set aside certain radio frequencies for the exclusive use of airplanes and stations. Weather reports, maps, and research projects undertaken by the Federal government contributed much toward the development of air traffic.[23]

[19] Public Act No. 706, 75th Congress, 3d Session, Sec. 401.

[20] Public Act No. 706, 75th Congress, 3d Session, Secs. 403 and 404.

[21] Public Act No. 706, 75th Congress, 3d Session, Sec. 407.

[22] Public Act No. 706, 75th Congress, 3d Session, Secs. 408 and 412.

[23] See Annual Report of the Assistant Secretary of Commerce for Aeronautics, 1931, pp. 11 and 18. See also the article by Langeluttig and Freedman in 4 *Journal of Air Law* 303.

In the compensation paid to air transportation companies for the carriage of mail the Federal government was very generous, thereby hoping to encourage and to aid in the development of this type of transportation.

In the Civil Aeronautics Act of 1938 Congress has given further evidence of its intention not only to regulate air traffic but also to foster and to aid its development. The statute contains a number of important provisions which are designed to aid and encourage air commerce. A special officer known as the administrator has been provided for by the statute to carry out these provisions. The act states that the administrator is empowered and directed to encourage and foster the development of civil aeronautics and air commerce. He may designate and establish civil airways. He may acquire and operate along such airways all necessary navigation facilities. He is to make a survey of existing airports with recommendations for their development or improvement. He is empowered and directed to collect and disseminate information relative to civil aeronautics. He may undertake or supervise such development work and service testing as tends to the creation of improved air navigation facilities and aircraft.[24]

IV. State Regulation and Promotion of Aviation.

The states have had no occasion to regulate aviation as a business affected with a public interest because nearly all air commerce is interstate in character. They have, however, attempted to encourage and aid aviation and to make some police regulations which are designed to promote safety. Some of the state statutes are commendable because they seek to cooperate with the agencies of the Federal government which are engaged in regulating aviation. Although the states have not had an opportunity since the passage of the Civil Aeronautics Act of 1938 to enact supplementary legislation, some of them have had laws supplementing the Air Commerce Act of 1926. For example, a statute of Minnesota provided that it was unlawful for any person to operate or navigate any aircraft within the state unless such aircraft had been registered with the proper Federal authorities. Likewise the act required persons who navigated aircraft within the state to have licenses issued by the Federal

[24] Public Act No. 706, 75th Congress, 3d Session, Secs. 301, 302, 305, and 306.

government. The act set up a state commission and empowered it to prescribe air traffic rules and regulations but specified that such rules and regulations should not be inconsistent with the laws and regulations of the Federal government.[25]

States have aided in the promotion of aviation by erecting or allowing municipalities to erect airports and landing fields. In addition, states have marked out airways and provided for signals and guides on these airways.[26]

References

Public Act No. 706, 75th Congress, 3rd Session, Secs. 1, 201, 301, 302, 305, 306, 401, 403, 404, 407, 408, 412, 601, 602, 603, 604, 609, and 610.

Civil Air Regulations, Secs. 20.00 to 20.67, 24.00 to 24.40, and 60.00 to 60.93.

Annual Report of the Assistant Secretary of Commerce for Aeronautics, 1931, pp. 11–18.

"Promotion of Aeronautics by State Regulatory Bodies" by Langeluttig and Freedman, 4 *Journal of Air Law* 303.

Laws of Minnesota, 1933, Chap. 430.

[25] Laws of Minnesota, 1933, Chap. 430. For a summary and discussion of this law see the article by Fred D. Fagg in 4 *Journal of Air Law* 340.

[26] See "Promotion of Aeronautics by State Regulatory Bodies" by Langeluttig and Freedman, 4 *Journal of Air Law* 3.

CHAPTER X

STATE CONTROL OF PUBLIC UTILITIES

Perhaps no other phase of government control of business has occasioned more controversy during the past fifteen years than the regulation of public utilities. The tremendous and rapid growth of the industry and the increasingly important place which it occupies has raised the question of adequate regulation to a position of paramount importance. In addition, several rather spectacular events have called the attention of the public to the problem. The investigation which was completed in 1936 by the Federal Trade Commission into the finances, intercorporate relations, and practices of public utilities revealed extensive propaganda which had spread even into the primary and secondary schools, the existence of large profits, and the prevalence of "write-ups" in valuation.[1] The crash of the Insull utility empire showed the insecure basis upon which some of these large units had been built and bared many undesirable and antisocial practices.

Persons interested in the problem of public utility control are divided into several groups. Some of these assert that government ownership and operation present the only adequate solution to the problem. Others contend that state regulation fortified at its weaker points by national regulation can adequately cope with the situation. Still others assert that we have had too much regulation and argue that less control would be desirable.

Although regulation of utilities as we know it today is a modern phenomenon, actually it is very ancient, even going back to the common law. Under common law certain obligations were imposed upon those engaged in public callings. In case of violation of the rules of the common law, an injured person had redress through the courts. Later, regulations were attempted through charters or franchises. Some of these required street

[1] Report of the Federal Trade Commission on Public Utility Corporations, 70th Congress, 1st Session, Document 92, Part 72A.

railways to operate their cars at specified intervals and others prescribed a certain fare.[2] Such franchises and charters were very rigid and did not allow that flexibility which is required to meet changing economic conditions. A fair rate or adequate service at the time the franchise was entered into might not be fair or adequate at a later date.

To provide more adequate, uniform, and flexible regulation, local boards were established and given authority to control public utilities. As utilities grew from local to statewide enterprises, these local boards or commissions were unable to regulate satisfactorily.

The early part of the nineteenth century witnessed most states passing from local to state regulation. Today every state with the exception of Delaware has a state commission which may exercise some control. These bodies are called by various names, railroad commissions, corporation commissions, public service commissions, or public utility commissions. Their jurisdiction varies greatly not only as to the kinds of utilities controlled, but also as to the kinds of control over the utilities subject to their authority.

I. The Concept of a Public Utility.

The question of what is a public utility or a business affected with a public interest is one which has bothered both courts and commissions. The question is one of importance because of the limitations which the due process clause of the Fourteenth Amendment imposes upon the states. The due process clause of the Fourteenth Amendment declares that no state shall deprive any person of life, liberty, or property without due process of law. To regulate business is depriving persons of liberty or property. Under the police power, however, the states have been permitted to regulate business to a certain extent in order to protect health, morals, safety, or general welfare of the public. Even over private business some control is permissible, particularly control which protects the health, morals, or safety. Thus the state may compel the installation of safety devices, require sanitary conditions, and otherwise protect the health of workers.

[2] Macon Railway and Light Co. v. Corbin (1923) 155 Ga. 197, 116 S. E. 305; City of Potwin Place v. Topeka Ry. (1893) 51 Kan. 609, 33 P. 309.

But over public businesses the state may go even farther and impose upon these enterprises regulatory features which cannot constitutionally be imposed upon private businesses.

But what are public businesses? Certainly there is no fixed category. By change of circumstances a business may be raised from the class of a private business to one which is public. Furthermore, in times of emergency the state may impose regulations which in ordinary times would not be permissible. The emergency housing regulations enacted by the legislature of New York afford a good illustration of this.[3] But in a situation not ordinarily regarded as an emergency, what is a business affected with a public interest? The courts have said that a business is public if the public has become peculiarly dependent thereon.[4] Such a statement is merely begging the question. Certain features seem to be essential, however. One is the existence of monopolistic control; another is the furnishing of a product or service which is necessary to the public. But some businesses are still considered to be public even though they do not have both of these characteristics.

The most obvious examples of public businesses or businesses affected with a public interest are the many kinds of common carriers and companies which are engaged in furnishing gas, electricity, steam heat, water, cold storage facilities, and telephone and telegraph communication. Likewise, courts have held that inns, grain elevators,[5] warehouses,[6] and insurance companies are businesses affected with a public interest.[7] But courts have held that the regulation and distribution of ice;[8] the operation of

[3] People v. La Fetra (1921) 130 N. E. 601, 230 N. Y. 429; Levy Leasing Co. v. Siegel (1920) 186 N. Y. S. 5, 194 App. Div. 482.

[4] Wolff Packing Co. v. Court of Industrial Relations (1923) 262 U. S. 522, 67 L. Ed. 1103, 43 S. Ct. 630.

[5] Munn v. Ill. (1876) 94 U. S. 113, 24 L. Ed. 77; Budd v. N. Y. (1892) 143 U. S. 517, 36 L. Ed. 247, 12 S. Ct. 468; Brass v. N. D. (1894) 153 U. S. 391, 38 L. Ed. 757, 14 S. Ct. 857.

[6] See, for example, Revised Code of Arizona, 1928, Sec. 3274; Mason's Minnesota Statutes, 1927, Sec. 5123.

[7] German Alliance Ins. Co. v. Lewis (1914) 233 U. S. 389, 58 L. Ed. 1011, 34 S. Ct. 612; People v. Elgin Home Protective Ass'n (1935) 194 N. E. 584, 359 Ill. 379.

[8] New State Ice Co. v. Liebmann (1932) 285 U. S. 262, 76 L. Ed. 747, 52 S. Ct. 371.

employment agencies,[9] barbershops,[10] and dry cleaning establishments;[11] the buying and selling of theater tickets;[12] and the buying and selling of gasoline are not public businesses.[13] Yet the courts have held that the milk business is sufficiently affected with a public interest to justify price regulation.[14]

Even though a business is of a kind which would ordinarily be public in its nature, such as the business of furnishing gas, water, or electricity, it may not be public because of the limited number of persons who are served. Generally speaking, there are three classes of utilities: private, contract, and public. The line between these is not always easy to draw. If a man has a plant which furnishes electricity or water for himself, obviously he has a private business. If he furnishes service to a few persons under contract he is operating a contract utility. But if he holds himself out expressly or by a course of conduct to serve all who may desire the service to the limit of his capacity, he is then regarded as public. Although a state may not convert private or contract utilities into public utilities without violating the due process clause of the Fourteenth Amendment, it may undoubtedly regulate them to some extent.

In this chapter we are concerned only with those public businesses which are ordinarily designated public utilities, gas, telephone, telegraph, water, electricity, steam heating, cold storage plants, and street railways. Railroads and motor carriers also are frequently considered to be in this group, but they have already been treated in previous chapters.

Frequently the statutes of a state give to a public service commission jurisdiction over public utilities and then go on to define the term public utility. The statutes of Missouri declare that the term public utility includes every common carrier, pipe-

[9] Ribnik v. McBride (1923) 277 U. S. 350, 72 L. Ed. 913, 48 S. Ct. 545.

[10] State v. Ives (1936) 167 So. 394, 123 Fla. 401; City of Mobile v. Rouse (1937) 173 So. 254.

[11] Becker v. State (1936) 185 At. 92; Kent Stores v. Wilentz (1936) 14 Fed. Supp. 1; City of Mobile v. Gibson (1937) 173 So. 266, 233 Ala. 622.

[12] Tyson and Bros. v. Banton (1927) 273 U. S. 418, 71 L. Ed. 718, 47 S. Ct. 426.

[13] Williams v. Standard Oil Co. (1929) 278 U. S. 235, 73 L. Ed. 287, 49 S. Ct. 115.

[14] State v. Newark Milk Co. (1935) 179 At. 116, 118 N. J. Eq. 504; Franklin v. State (1936) 169 So. 295, 232 Ala. 637.

line corporation, gas corporation, electrical corporation, telephone corporation, telegraph corporation, water corporation, and heat or refrigerating corporation as these terms are defined in the act. The act then defines specifically each of the kinds of corporations designated as public utilities. For example, the term "telephone corporation" includes every corporation, person, etc., owning, operating, or managing any telephone line used in the conduct of the business of affording telephonic communication for hire.[15]

Several states have now brought public utility holding companies under the jurisdiction of their public service commissions.[16]

II. Entry into Service.

At common law no restrictions were imposed upon the entrance into service of a business which was public in its nature. In modern times governmental authorities have imposed limitations of two kinds, franchises and certificates of convenience and necessity.

The franchise is the earlier type of permission. In general it is a permit from the state or local authorities conferring upon corporations or individuals some special privilege, such as occupying the streets and highways with tracks, poles, pipes, and other equipment necessary to the furnishing of service to the public. Such privilege often, but not always, confers a monopoly.

Before the days of public utility commissions, franchises were often used as regulatory devices. It was not uncommon to insert definite rate or service provisions. Such provisions were subject to the obvious objections that they were inflexible and not susceptible to changes required to meet new conditions.

Franchises may be classified as follows: perpetual franchises, long-term franchises, short-term franchises, and indeterminate permits. Perpetual franchises, although not common, have sometimes been granted. The short-term franchises running for five or 10 years have often been employed. The uncertainty of renewal made them highly unsatisfactory from the point of view of the utility. As a result, the public might suffer because of the unwillingness of the utility to extend service because of

[15] Revised Statutes of Missouri, 1929, Sec. 5122.

[16] See for example, Wisconsin Laws of 1933, Chap. 440, Sec. 2; Session Laws of Washington, 1933, Chap. 152, Sec. 2.

uncertainty as to its future status. In general, the long-time franchise has been more satisfactory.

Objections to both long- and short-term franchises led some states, Indiana and Wisconsin among others, to substitute the indeterminate permit for the franchise.[17] Here the duration of the permit is indefinite and usually conditioned upon certain factors. One is the good behavior of the utility. Another is the desire of a municipality to take over the plant upon the payment of just compensation and operate it as a public enterprise.

In theory the indeterminate permit is highly desirable since the utility has security and the interests of the public are protected. In practice it sometimes results in monopoly without the safeguards supposedly imposed for the benefit of the public. A good illustration was to be found in Indiana. The Indiana statute provided that a city might acquire a public utility on payment of just compensation. The town of North Manchester sought to acquire that part of a large electric system which lay within its borders. Upon petition to the commission, the commission decided that it had no jurisdiction because the plant was merely part of a larger system, most of which lay outside the town limits.[18] As most Indiana cities were served by plants which were parts of large systems, the effect was to nullify this provision of the statute.

The second type of permit often required before utilities may commence operation is the certificate of convenience and necessity. This is given to utilities after a showing that public needs require the proposed service. Certificates of convenience and necessity have been discussed in detail in the chapters on railroads and motor carriers.

The necessity of requiring the two types of permission, the indeterminate permit and the certificate of convenience and necessity, is not clear where the public service commission issues both, as is done in some states. All the desirable purposes could be achieved if certificates of convenience and necessity were

[17] Wisconsin Statutes, 1931, Secs. 196.54–196.55; Burns's annotated Statutes of Indiana, 1933, Secs. 54–604 and 54–605. See "The Indeterminate Permit for Public Utilities" by E. B. Stason, 25 *Michigan Law Review* 354–392.

[18] *In re* Town of North Manchester, Order No. 10598 of Indiana Public Service Commission, approved Nov. 27, 1931.

issued with provisions for their revocation and for public acquisition and operation of a utility on payment of just compensation.

III. Service.

The phases of public utility control in which patrons are most interested are services and rates. Both are of importance although people are inclined to view rate control as the more important. If utility commissions had had as much difficulty in obtaining adequate service as they have had in securing reasonable rates, the public might appreciate the importance of this phase of regulation. Utilities have in general been ready to give adequate service without great coercion from regulatory authorities but have not shown the same willingness to fix reasonable rates.

Statutes of some states declare that if commissions find that additions, extensions, or improvements in any existing plant ought reasonably to be furnished, the commission shall make an order so directing.[19] In general, the courts have held that this power extends only to service in territory which the utility has held itself out to serve. Therefore commissions cannot order extensions into fields which the utility has not held itself out to serve.[20]

The laws of many states provide that utilities must furnish safe and adequate service and facilities. In general, the statutory provisions do not go into further detail except to provide methods of compelling the fulfillment of this obligation. Upon petition of local authorities or certain persons specified in the statute, or upon a motion of the commission, a hearing may be held. If after the hearing the commission finds that the service or facilities are inadequate or unsafe, they may issue an order.[21] Sometimes such order is to remedy inadequacy of service for a particular utility which is before the commission; sometimes it is a general order fixing certain standards or requirements of service for all utilities similarly situated.

In a number of the states, commissions have set standards for various utilities. In the case of companies engaged in furnishing

[19] Illinois Commerce Commission Law, Sec. 50.

[20] State *ex rel.* Ozark Power and Water Co. v. Pub. Ser. Com. (1921) 287 Mo. 522, 229 S. W. 782.

[21] Burns' annotated Statutes of Indiana, 1933, Secs. 54–408 and 54–424.

electricity, the standards usually pertain to voltage, accuracy of meters, and similar matters.[22] Many state commissions have fixed standards for the furnishing of gas by prescribing heating content, purity, and pressure. Some utility commissions have set standards for telephone service but these are of little consequence except for small companies because the requirements of public authorities have in general lagged behind the standards of service and performance of the large telephone companies.[23]

IV. Abandonment of Service.

The rule has become well established that public utilities may not abandon service without permission from some governmental agent. The obligation to continue service arises from different sources. In some cases it arises from a statute which definitely states that no public utility may abandon service without permission. In other cases the duty is implied from a statutory provision requiring safe and adequate service. In still other cases it arises from terms of a charter which definitely provides that the utility must continue service for a certain period of time. In others it apparently arises from a grant of special privilege such as eminent domain, special use of the streets, monopoly, or gifts of land or money from the public.[24]

Despite the general rule that a utility may not discontinue without the consent of the state, certain circumstances justify discontinuance even though the state objects. If the utility is operating its entire system at a loss, the state cannot compel continuance of service. To do so would constitute a taking of property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States. The state may compel the continued operation of a part of a utility system even though operation of the part results in a loss. However, the operation of a branch at a loss is a cogent reason for permitting discontinuance.

Commissions before permitting abandonment often require that all other alternatives be tried, such as increasing or decreas-

[22] Rules and Standards of Service for Electrical Utilities established by Public Service Commission of Indiana, 1920.

[23] See "Public Utility Regulation" by Mosher and Crawford, p. 173.

[24] See "Discontinuance of Service by Public Utilities" by Ford P. Hall, 13 *Minnesota Law Review*, pp. 182–196.

ing rates, improving or lowering the quality of service, or allowing others to take over and operate the system.

V. Rates.

Of all the problems of utility regulation that of rate control has caused commissions the most difficulty. The number of cases involving rates which have come before public service commissions are extremely numerous. Most of the controversies and debates over public utilities have centered about rate control. Utilities are organized to secure a maximum profit. Utility commissions have been established to protect the public and to see that rates are not exorbitant. When commissions have earnestly tried to perform their duty, a conflict of interests has ensued. Utilities have been disposed to challenge at every turn restrictions on the power of commissions to fix rates and have rushed to state and Federal courts for protection, usually on the grounds that their property is being taken without due process of law. This extensive resort to the courts has at times nearly paralyzed effective rate control by state commissions.

Briefly stated, the rule has been established that the rates of a public utility shall be fixed so that a company may earn a fair return upon the value of its property over and above reasonable operating expenses. Under this rule there are three important questions. What are reasonable operating expenses? How is the value to be ascertained? And what is a fair return?

Obviously, proper rate control requires some supervision of operating expenses. If a utility can have a return over and above any operating expenses which it may incur, the temptation is to be extravagant and to pass the bill on to the public in the form of higher rates. To prevent this, the rule has developed that rates shall be fixed so as to provide a fair return above the reasonable cost of ordinary and efficient operation. An interesting case on this point is *Reno Power Light and Water Company v. Public Service Commission.*[25] The company had filed with the commission a new schedule increasing rates. The commission disapproved of certain operating expenses which the company had claimed. The utility had paid too much for oil; had paid more in salaries and for labor than was warranted under existing condi-

[25] Reno Power Light and Water Co. v. Pub. Ser. Com. (1923) 298 Fed. 790.

tions; had listed bad debts which the commission found were the result of negligence on the part of the company; had listed a large sum for rate controversies in one year, a sum which should have been divided and spread over five years; and had placed among expenses such items as picnics, photographs of employees, gifts to charity, and stock subscriptions in a local rodeo enterprise. The commission and the court objected to all of these items and refused to approve them as reasonable operating expenses.

The question of how to ascertain the value of a public utility is one which has caused great difficulty to courts and commissions. Obviously if a return is to be based upon the value of the property of a public utility, such value must be kept within proper limits or the whole scheme of rate control breaks down. To impose no limits upon value is simply to allow a monopolistic business to charge what the traffic will bear. A low return on a high value is quite as satisfactory to a utility as a high return on a low value. In fact, perhaps it is more satisfactory in that it leads the public to believe that rates after all are not too high.

Perhaps nowhere is the system of utility control weaker than in valuation. Several bases have been suggested for valuation of a public utility, but none is entirely satisfactory. Capitalization is a possible basis. Unless, however, a commission has proper control over the issuance of stocks and bonds, such a base will be unfair to the public. Utilities could issue stocks and bonds indiscriminately and then expect the public to pay rates which would be high enough to give them a return on a grossly inflated capitalization. By stringently controlling the issuance of stocks and bonds the Massachusetts Commission, however, has apparently been successful in its use of capitalization as the base for determining rates. " . . . the Massachusetts plan . . . is founded on a policy . . . which provides that the relations between the state and the utilities are mutually fair when the state approves the issue and the issue price of every share of capital stock; and when rates are so fixed as to permit dividends on the stock. . . . "[26]

Sale value has been suggested as a basis for valuation. In fact, utilities have often sought to use the price at which a system has been purchased as the basis upon which to fix a return. In

[26] Report of the New York Commission on Revision of the Public Service Commission Law, 1930, p. 97.

general, however, commissions have not looked with favor upon this procedure. Many state commissions have had no control over sales or consolidations, and as a result utilities have sometimes paid prices far in excess of a fair value for rate-making purposes. From the point of view of a utility a high sale price is sometimes justifiable, but the rate-paying public should not be called upon to pay the bill. In approving a sale or consolidation a commission often states that the valuation or price shall not necessarily be used as a basis for rate making.[27]

Tax value has sometimes been suggested as a basis.[28] This is not looked upon with favor by utilities since their tax value is often considerably below their real value or the value which they would like to establish for rate-making purposes.

Fair value is a basis which has on several occasions received the approval of the Supreme Court of the United States. In the famous case of *Smythe v. Ames* the court indicated that the factors which should be considered in determining fair value are the original cost of construction, the amount expended in permanent improvements, the market value of stocks and bonds, the present cost of construction, the earning capacity under certain prescribed rates, a sum required to meet operating expenses, and such other matters as may be pertinent.[29] In a comparatively recent case, *Los Angeles Gas and Electric Company v. Railroad Commission*, the Supreme Court reaffirmed the doctrine of fair value.[30] Despite judicial approval there are many objections to the use of fair value as a rate base. For one thing, it is little more than a guess. For another thing, there is no certainty as to the weight which should be given to each factor. Furthermore, it provides a fluctuating base.

Another base which has been used to determine the value of a public utility is the cost of reproduction new less depreciation.[31] Roughly speaking, the cost of reproduction would include the

[27] *In re* Princeton Telephone Co., P.U.R. 1923 A 620 (Ind.).

[28] See the statement in Laws of Indiana, 1933, Chap. 190, Sec. 4, concerning the valuation of land of public utilities.

[29] Smythe v. Ames (1898) 169 U. S. 466, 42 L. Ed. 819, 18 S. Ct. 418.

[30] Los Angeles Gas and Elec. Co. v. Railroad Com. (1933) 289 U. S. 287, 77 L. Ed. 1180, 53 S. Ct. 637.

[31] McCardle v. Indianapolis Water Co. (1926) 272 U. S. 400, 71 L. Ed. 316, 47 S. Ct. 144.

cost of reproducing such tangibles as land, buildings, and equipment, and certain sums for incidentals incurred during construction, such as costs of administration, engineering, superintendence, legal expenses, brokerage and promotion fees, taxes, bond discounts, and contingencies.[32] In addition, commissions usually allow a sum for such intangibles as *going value* and *working capital.* Utilities have tried to obtain additions to the above items by claiming a value for other intangibles, such as franchises and good will, but have almost consistently met with rebuffs from commissions and courts.

As has been previously pointed out, state commissions have usually allowed sums for *going value. Going value* is supposed to represent the difference in value between a firm actually assembled, established, and doing business and one not thus far advanced. The concept is vague and the methods of ascertaining are difficult to determine.[33] Usually commissions have taken an arbitrary figure, about 10 per cent of the value of tangible property and added it to the sum which they have found to be the valuation of the tangible property of a public utility.

A sum for working capital is usually allowed in the rate base in figuring the cost of reproduction. Working capital represents a reasonable amount of cash and supplies, such as coal, tar, wire, pipes, etc., which are not figured in an inventory of the physical property but which are necessary to meet the constantly recurring demands incidental to the proper conduct of the business of a utility.

The cost of reproduction new as a basis for valuation has been severely criticized by many persons. Undoubtedly such a basis is replete with uncertainties. Even as to tangibles it is little more than a guess. Add to this the necessity of estimating the *going value* and the uncertainties are multiplied. Furthermore cost of reproduction is a fluctuating basis because as prices change the rate base must fluctuate. This encourages and gives rise to rate controversies which are time consuming and costly to the government, consumers, and utilities.

[32] See Report of the Special Committee on Valuation of the American Society of Civil Engineers referred to on p. 195 of "Public Utility Regulation" by Mosher and Crawford.

[33] See report of the New York Commission on Revision of the Public Service Commission Law, 1930, pp. 359–360.

Another basis which has been suggested is prudent investment. According to this, a utility should be allowed to earn a fair return on the amount of money prudently invested. Prudent investment would at least give a nonfluctuating rate base. Nevertheless, some uncertainty would still remain in trying to determine what part of an investment in the properties of a public utility had been prudently made. In an able dissenting opinion Justice Brandeis in the case of *Southwestern Bell Telephone Co. v. Public Service Commission* strongly urged the adoption of prudent investment.[34]

Once the valuation has been found, the problem of determining a fair return causes some difficulty. The return to which a public utility is entitled is supposed to be high enough to support its credit so that it can obtain money to discharge properly its public duties. In other words, utilities are entitled to a return equivalent to that of other business undertakings which are attended by corresponding risks and uncertainties and which operate in the same general part of the country.[35] That is to say, three factors are important: locality, circumstances, and risk. In some parts of the country higher interest rates are paid. Also interest rates vary from year to year in the same locality. Furthermore if a utility has a monopoly and its future success seems assured, the commission as a rule will not allow as high a rate as it does where a utility does not have a monopoly or there is uncertainty as to its probable future success. In general, commissions have been quite liberal, often allowing as much as 10 per cent upon the estimated valuation.[36]

In addition to fair return the courts usually allow a sum for depreciation. This sum varies depending upon the estimated length of life of a utility plant. The reason for allowing a sum for depreciation is that courts believe that investors are entitled to have their capital investment kept intact.

Granted that a utility is entitled to earn a fair return on the value of its property over and above operating expenses, the problem still remains of setting particular rates. In theory it may

[34] Southwestern Bell Tel. Co. v. Public Ser. Com. (1923) 262 U. S. 276, 67 L. Ed. 981, 43 S. Ct. 544.

[35] Bluefield Waterworks and Improvement Co. v. Pub. Ser. Com. (1923) 262 U. S. 679, 67 L. Ed. 1176, 43 S. Ct. 675.

[36] See Wabash Valley Elec. Co. v. Singleton (1932) 1 Fed. Supp. 106.

be assumed that each rate should be set so that each class of consumers would bear a fair proportion of the expenses. In practice this is not always done. For instance, in the case of electricity, consumers are commonly divided into three classes: domestic, commercial, and industrial. Among these groups, domestic consumers have often borne more than a fair share of expenses owing in part at least to a lack of bargaining power. Industrial users have been in a position to institute legal proceedings or to threaten to produce their own power unless the utility meets their demands. Often a utility will violate the principle of each rate bearing a proportional share of operating expenses by the use of low promotional rates to stimulate the use of electricity at certain hours of the day.

The difficulties of commission regulation of public utility rates have been increased because of appeals to the courts. Utilities which are displeased seek to have decisions reviewed and reversed by the courts. The statutes of the states provide various methods of reviewing decisions of public service commissions in the state courts. In many states if a utility fails to comply with an order of a commission, the commission may bring suit to compel enforcement by mandamus or mandatory injunction. Frequently a utility which objects to the order of a public service commission may sue to enjoin the enforcement of an order or to have the order set aside. Sometimes state statutes provide that the orders of the public service commission shall be final on questions of fact.

Logically, state courts are the proper tribunals to review decisions of public service commissions. However, Federal courts have often taken jurisdiction, sometimes on the grounds of diversity of citizenship but more frequently because of an allegation that property is being taken without due process of law in violation of the provisions of the Fourteenth Amendment. Such interference has further complicated the problem of regulation. Federal courts have sometimes made entirely new valuations and have almost completely ignored the valuations of state commissions. This is unfortunate because courts have neither the information nor the technique of public service commissions. In order to curb the tendency of public utilities to resort to the Federal courts, Congress passed the Johnson Act. This provides that the Federal courts shall not have jurisdiction to enjoin an

order of an administrative board or commission of a state or any rate-making body of any political subdivision where there is a speedy and efficient remedy in the state courts.[37]

VI. Discrimination.

Public utilities are required not only to give adequate service at reasonable rates but also to serve without discrimination. Commissions are usually given the power to remove discriminations.[38] In certain cases the dangers of discrimination are greater than in others. To discriminate between domestic consumers of electricity is not especially damaging to the unfavored party but to discriminate between industrial consumers in the furnishing of electricity may be disastrous to the party discriminated against. A manufacturer might be placed at a decided disadvantage if his rival were given lower rates and both were dependent upon electricity for manufacturing purposes.

In general, only unjust or unreasonable discrimination is prohibited. Differences in rates founded upon differences in cost are justifiable.[39] It is in part upon such theory that consumers have been classified into domestic, commercial, and industrial groups and different rates have been fixed for each group.

VII. Mergers, Consolidations, Stock Acquisitions.

One of the outstanding developments in the field of public utilities during the past fifteen years has been the centralization of control. The changes in ownership and control have been rapid and kaleidoscopic. The benefit of unification to consumers cannot be disputed. Better terms for financing, quantity purchases, elimination of duplication, more expert engineering advice, and lower costs may result from a combination of utilities, and this in turn may lead to lower rates and better service. Most of the advantages of unification may acrue to utilities, however, unless the interests of consumers are properly protected by public authorities. Undoubtedly, states have had it within their power to safeguard the interests of consumers and to guide concentrations into channels which are beneficial to the public without

[37] U. S. Code, Title 28, Sec. 41(1).

[38] Illinois Commerce Commission Law, Secs. 38 and 41.

[39] See "Public Utility Regulation" by Mosher and Crawford, pp. 260–262.

doing any injustice to the utilities which are rendering the service. As is too often the case, however, the legal and political safeguards have lagged far behind the economic phenomena and states have failed to protect the consumers who have a vital interest in unification proceedings.

Failure to control this phase of public utility activity has led to much of the criticism of state control. Only about half of the states have some form of regulation over sales, mergers, consolidations, or stock acquisitions by public utilities. Even in those states which have endowed their commissions with control, authorities have not always exercised their power so as to protect the public interest sufficiently.

In the states which have comprehensive statutes covering this subject, public utilities are forbidden to consolidate, merge, lease, or sell their property or to acquire the stock of any other public utility without the consent of the public utilities commission. In some states, commissions will approve only if the proposal is for the benefit of the public.[40]

Although a valuation is not usually required by statute, it is quite often made by commissions before permitting a unification. As a rule, they use the cost of reproduction new less depreciation as a basis for valuation. Generally, as in rate cases, sums for going value and working capital are allowed. Often commissions attach certain conditions of varying kinds. Sometimes these are for the benefit of stockholders and sometimes for the protection of the public.[41]

If a statute requires commission consent for merger, consolidation, or sale, a transaction which is made without sanction from the designated authority is void.

VIII. Security Issues.

An important phase of the control of public utilities is that pertaining to security issues. The investing public has a direct interest in such control, and even the consuming public has a vital, if indirect, concern. Although, theoretically, capitalization should not affect rates, in reality it probably does. Commissions and courts in scanning rates and returns are undoubtedly

[40] Illinois Commerce Commission Law, Sec. 27.

[41] "State Control of Consolidation of Public Utilities" by Ford P. Hall, 81 *Pennsylvania Law Review* 8.

impressed if a utility is unable to earn more than a small return upon its capitalization even though such capitalization greatly overestimates the real value of the utility. Furthermore, overcapitalization may result in poor service. Officials naturally endeavor and are under pressure from stockholders to pay dividends. To meet these payments on a high capitalization, money is often taken which should be used for improvements of service.

Despite the fact that security regulation is necessary for adequate control of rates and service, many states have no provisions for it. Several states have given their commissions control over the issuance of stocks and bonds of some but not all kinds of utilities.

In states which control securities, statutes prohibit the issuance of stocks, bonds, or other evidences of indebtedness without commission consent. A common type of statute is that found in California which allows public service companies to issue stocks, bonds, or other evidence of indebtedness when necessary for the acquisition of property, the construction or improvement of facilities, the improvement or maintenance of service, or the discharge or refunding of obligations. An order must be secured from the commission authorizing the issue, and stating that in the opinion of the commission the indebtedness is reasonably required for the above-mentioned purposes of the corporation.[42] The New York Public Service Commission Law states that the commission may authorize the issuance of securities for the acquisition of property, construction, completion, extension, or improvement of facilities, improvement or maintenance of service, discharge or refunding of obligations, and the reimbursement of moneys actually expended from income.[43] In interpreting this provision the New York Public Service Commission has stated:

> The enumeration of purposes for which stocks, bonds, and other evidences of indebtedness may be issued is exclusive and not inclusive, and such securities may not be issued for purposes not enumerated in the statutes either with or without authorization of the Commission.[44]

[42] Public Utilities Act of California, Sec. 52(b).

[43] Public Service Commission Law of New York, Sec. 69.

[44] *In re* Central Hudson Gas and Elec. Co., 3 N. Y. P. S. C. 2d Dis. 380.

IX. Accounts.

The proper regulation of the accounts of public utilities is an important phase of governmental control. Although the public is not usually greatly interested, such control underlies adequate regulation of rates and services.

Adequate control of accounting should include the power to prescribe the classification of accounts. Uniformity here is important. With this in view the National Association of Railroad and Utilities Commissions has prepared such classifications for electric light and power companies, for gas companies, and for water companies. Many commissions have adopted these classifications especially for electric utilities.[45]

Another important phase of this type of control is the requirement of reports on certain forms designated by commissions. The statutes of many states give to commissions the power to require reports from utilities under their jurisdiction.

An important feature of accounting control, and one which has been much neglected by commissions, is field auditing, or what is sometimes called the policing of accounts. Even though this phase of accounting control is highly desirable, few commissions have had either the men or the money with which to make adequate field surveys.[46]

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[45] See "Principles of Public Utilities" by Jones and Bigham, p. 456.

[46] See "Public Utility Regulation" by Mosher and Crawford, pp. 134–135.

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CHAPTER XI

FEDERAL CONTROL OF PUBLIC UTILITIES

For the past few years there has been an increasing demand for Federal regulation of public utilities. This has been due largely to the increase in interstate operations of various kinds of utilities.[1] A few years ago utilities were locally owned and operated enterprises which were essentially intrastate in character. In recent years, however, there has been a steady increase in interstate operations. Likewise mergers, consolidations, sales of plant facilities, and stock transactions have transferred the management and control of utilities to a few large holding corporations which now dominate the industry.[2]

The concentration of control, the increase in the size of industrial units, and the growth of holding companies have multiplied the difficulties of effective state regulation. These economic phenomena have demanded changes in legislation and political machinery which states have been slow to adopt. A few states provide little or no effective control of public utilities.[3] Many states do not give to their commissions either adequate funds or an adequate staff to insure effective regulation. The increase in the size of utility enterprises has enhanced their financial strength and enabled them to fight strenuously every attempt to subject them to unwanted control. Furthermore, the fact that many of the large companies engage in interstate commerce in furnishing electricity, natural gas, and radio and telephone

[1] For a discussion of the ratio of interstate to intrastate power, see "Interstate Transmission of Electric Power" by Hugh L. Ellsbree, p. 59.

[2] Some of the important groups or corporations which exercise extensive control over the electric industry are Electric Bond and Share, Standard Gas and Electric, Cities Service, Associated Gas and Electric, Columbia Gas and Electric, and Commonwealth and Southern. For the extent and nature of the control of these and other utility groups see Moody's "Manual of Investments, Public Utilities," 1936.

[3] Delaware, for example, has no state public utilities commission.

communication has given rise to certain legal obstacles to state regulation.[4]

The past few years have witnessed much serious criticism of state control.[5] In seeking a remedy for the situation, many persons have advocated Federal regulation. In response to these demands the Federal government has enacted legislation regulating to some extent various kinds of public utilities. The Federal government has regulated the production and distribution of electricity through the Federal Power Commission, the transmission of natural gas through the Federal Power Commission, public utility holding companies through the Securities and Exchange Commission, radio communication through the Federal Communications Commission, and telephone and telegraph communication through the Federal Communications Commission.

I. Regulation of Electric Utilities.

The Federal Water Power Act of 1920 which created the Federal Power Commission and endowed it with certain regulatory and licensing functions represented a hesitant effort on the part of the United States to effect some control over water power sites and some regulation over the production and distribution of electricity. Subsequent legislation has broadened this control. At present the commission has jurisdiction over two groups of electric utilities, those which are located on the navigable waters or the public lands of the United States and those which engage in the interstate transmission of electricity.

1. *Electric Utilities on the Navigable Waters or Public Lands.* The powers and the functions of the Federal Power Commission over electric utilities which are located on the navigable waters or public lands of the United States can be divided into four important categories: the conduct of investigations; the issuance of permits and licenses; the control of accounting; and the regulation of rates, services, and security issues of licensees. Although

[4] Pub. Util. Com. v. Attleboro Steam and Elec. Co. (1927) 273 U. S. 83, 71 L. Ed. 549, 47 S. Ct. 294.

[5] See for example the Report of the House Committee on Investigation of the Public Service Commission and Public Utilities Companies in Pennsylvania, 1931; and the Report of the Commission on Revision of the Public Service Commissions Law in New York, 1930.

these powers sound formidable, certain qualifications render some of them innocuous. This is especially true of the provisions pertaining to rates, services, and security issues.

The statute provides that the commission is to investigate and gather data on the water resources of any region which is to be developed. The commission is instructed also to study the relationship of the water power industries to other industries and to interstate and foreign commerce. It is to investigate the location, capacity, cost of development, and the relation to markets of power sites. From time to time the commission is to publish the information and data which it secures.[6]

The commission is given authority under the statute to issue *preliminary permits* and *licenses* for the construction of dams, power houses, transmission lines, or other similar projects which are to be constructed on the streams over which Congress has jurisdiction under its authority to regulate interstate commerce or which are to be constructed on any public lands or reservations belonging to the United States. It is immaterial whether persons who plan such projects are expecting to use the water power for industrial purposes or to produce electricity.

A preliminary permit is issued by the commission to an applicant in order to give him priority over other persons who may desire to develop the same site. During the period of the permit an applicant must prepare reports, maps, specifications, and estimates to be submitted to the commission in support of his application for a license; he must secure from the state in which the project is to be situated the necessary authorization to operate; and he must make arrangements for financing the enterprise. A preliminary permit is issued for a period of time sufficient to enable the applicant to prepare the necessary papers and to make the required arrangements. In no case may its duration extend beyond three years. Such permit may not be transferred and is subject to cancellation by the commission.[7]

A license is a long-time authorization issued by the commission granting permission to construct and operate the power project which has been proposed in the preliminary permit. As has been stated above, each applicant is required to submit such plans, specifications, and estimates as are essential for an adequate

[6] Public Act No. 333, 74th Congress, 1st Session, Sec. 202.

[7] Public Act No. 333, 74th Congress, 1st Session, Secs. 202 and 203.

understanding of the proposed enterprise. It is also necessary to give satisfactory evidence that the required state permission has been obtained and that the laws of the state within which the project is to be located have been complied with.[8] Licenses may be issued to citizens of the United States, to any corporation organized under the laws of the United States or any state, or to any state or municipality.[9] Not all persons who receive preliminary permits are granted licenses. Some of the applicants fail because they cannot secure the necessary authorization from a state. Others fail because they are unable to make satisfactory arrangements for financing the proposed project. Some are refused permission because the commission does not find that the erection and operation of the project will be consistent with the public interest.[10]

Licenses are issued subject to certain conditions enumerated in the Federal Water Power Act. (1) Since the proposed project must be adapted to a comprehensive scheme for improvement and utilization of the water for navigation and power purposes, the commission may require the modification of any part of the plans before giving its approval. (2) Except in case of emergency no substantial alteration can be made in the project without the consent of the commission. (3) The licensee is required to keep the works in good repair for purposes of navigation and efficient operation of the project. (4) After the first 20 years of operation, the licensee must establish amortization reserves out of any surplus which it accumulates in excess of a reasonable rate of return. (5) The licensee must pay to the United States annually a certain sum for the cost of administering the act, compensation for the use of United States lands and property, and excess profits until the state where the project is located makes some provision for preventing or appropriating them. (6) The licensee must reimburse the government or another licensee for any benefits resulting from the erection of storage reservoirs or other improvements. In addition to these conditions the commission may fix others which it deems necessary. In the case of minor projects these conditions may be waived by the commission.[11]

[8] U. S. Code, Title 16, Sec. 802.

[9] Public Act No. 333, 74th Congress, 1st Session, Sec. 202.

[10] See Annual Report of the Federal Power Commission, 1930, p. 1.

[11] Public Act No. 333, 74th Congress, 1st Session, Sec. 206.

The maximum period of time for which a license may be granted is 50 years. In many cases, however, the commission has granted them for 25 years, 10 years, and even shorter periods.[12] No license may be transferred *voluntarily* without the written approval of the Federal Power Commission. On the expiration of the license the United States has a right to take over any project on condition that the licensee is reimbursed for money expended in its investment. The government is to pay a fair value plus reasonable damages resulting from the severance of property taken by the United States from that which is retained by the licensee. Furthermore, net investment is not to include the value of any land or property of the United States, the value of the license, going value, good will, or prospective revenue.[13] Thus it can be seen that the statute attempts to guard against possible excessive claims of a utility in case the government decides to take over a project. Supposedly, this is to be accomplished in part by establishing a definite, certain, and determinable basis for valuation (net investment) instead of the fluctuating and uncertain basis, cost of reproduction; and in part by excluding from the net investment certain elements of value for which the public should not be charged but which sometimes find their way into the rate base.

A few words should be said concerning power projects on non-navigable waters over which Congress does not have jurisdiction under its authority to regulate interstate commerce. In such cases apparently there is no requirement that persons contemplating projects shall secure commission authorization. However, if such persons choose to do so they may file a declaration of intention. The commission then investigates to determine whether or not the proposed project will affect interstate or foreign commerce. If it finds that such commerce will be affected, the project cannot be pursued until a license has been secured. If the commission does not find that interstate or foreign commerce will be affected and the project is not to be built on Federal land, the statute gives permission to build the dam or project upon compliance with state law.[14]

[12] See the list of licenses issued by the commission, Annual Report of the Federal Power Commission, 1936, p. 39.

[13] Public Act No. 333, 74th Congress, 1st Session, Sec. 207.

[14] U. S. Code, Title 16, Sec. 817.

There were outstanding in 1937, 500 permits and licenses which had been authorized by the commission during the 17 years of its existence. Some of these were for major projects, some for minor projects (100 horsepower or less), and some were for transmission lines. Although in the greater number of cases licensees were public utility companies which were planning to use the water power for producing electricity, some of the licensees were private companies which were going to use the water power for mining or industrial purposes. In a few cases licenses were granted to municipalities for the production of electricity. Although the licenses were distributed from Alaska to Florida and from California to Maine, there were no projects in several of the states.[15]

One of the important tasks of the commission is to exercise some supervision over the accounts of licensees. The commission has authority to provide rules and regulations for the establishment of a system of accounts. It has the power to examine the books and accounts of licensees. It may require licensees to submit reports.[16] The purpose of giving to the commission control of accounting seems to be twofold: (1) to provide a record of expenses, earnings, and investments so that just compensation can be determined in case the government decides to take over the project; and (2) to provide a basis for regulation of rates and security issues.[17]

In enacting the Federal Water Power Act Congress apparently did not wish to deprive the states of authority over the production and transmission of electricity, because it definitely subordinated the Federal Power Commission to the several states in the matter of regulating the rates, services, and security issues of licensees. Insofar as regulation of intrastate business is concerned, the act provides that every licensee which is a public utility must abide by the reasonable regulations as to rates and services of the states in which the project is being operated. If a state has not provided for regulation of rates, services, or security issues, the licensee must agree to confer regulatory jurisdiction on the commission until the state makes some provision for

[15] Annual Report of the Federal Power Commission, 1937, pp. 32–35.

[16] Public Act No. 333, 74th Congress, 1st Session, Sec. 301.

[17] See the Statement in Annual Report of the Federal Power Commission, 1928, p. 7.

control.[18] When power is transmitted in foreign or interstate commerce, rates and services are to be just, reasonable, and nondiscriminatory. Whenever one of the states has not provided for a commission or some body to enforce these requirements or to regulate security issues, jurisdiction is conferred upon the Commission to regulate such matters.[19]

2. *Electric Utilities Engaged in Interstate Commerce.* In addition to the regulation of utilities which are located on the navigable waters or public lands of the United States, the Federal Power Commission has been given some control over electric utilities engaged in interstate commerce. Electric utilities come under the jurisdiction of the commission if they engage in the transmission of electric energy in interstate commerce or engage in the sale of electric energy at wholesale in interstate commerce.[20]

The Federal Power Commission has been authorized to facilitate the coordination of the power facilities of companies which come under its jurisdiction. In order to assure an abundant supply of electric energy the commission is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy. The commission may even order one public utility to establish physical connection with another utility if it finds such action necessary or appropriate in the public interest.[21]

No public utility may merge, consolidate, lease, sell, or otherwise dispose of the whole of its facilities without first having secured an order of the commission authorizing it to do so. The commission shall approve if it finds that the proposed arrangement is consistent with public interest.[22]

No public utility may issue any security unless the commission has authorized such issue. The commission is to approve only if it finds that it is for some lawful object, is compatible with public interest, and is reasonable, necessary, or appropriate for the proper performance of service as a public utility.[23]

[18] U. S. Code, Title 16, Sec. 812.
[19] U. S. Code, Title 16, Sec. 813.
[20] Public Act No. 333, 74th Congress, 1st Session, Part II, Sec. 201.
[21] Public Act No. 333, 74th Congress, 1st Session, Part II, Sec. 202.
[22] Public Act No. 333, 74th Congress, 1st Session, Part II, Sec. 203.
[23] Public Act No. 333, 74th Congress, 1st Session, Part II, Sec. 204.

All rates and charges must be just and reasonable. No utility may grant any undue preference or advantage to any person. Every public utility must file and keep open for public inspection its rates and charges. If the commission finds that any rate or charge is unreasonable or discriminatory, the commission may after notice and hearing fix the reasonable or nondiscriminatory rate or charge. In order to facilitate the task of fixing just and reasonable rates, the Federal Power Commission is given the authority to investigate and to determine the cost of production and transmission of electricity and the cost and value of the property of utilities subject to its jurisdiction.[24]

Whenever the commission shall find that any interstate service of any public utility is inadequate or insufficient, the commission shall order the utility to establish proper, adequate, or sufficient service.[25]

The commission has the power to require uniform accounts, to inspect and examine all accounts and records, and to require reports of all utilities subject to its jurisdiction.[26] The commission has also been given considerable power to investigate and study the generation, transmission, distribution, and sale of electric energy throughout the United States in order to secure information as a basis for recommending legislation to Congress.[27]

II. Regulation of the Transportation of Natural Gas.

The interstate transportation of natural gas is one of the significant and recent developments in the field of public utilities. The United States is covered with a vast network of natural gas pipe lines extending from Texas and Oklahoma north to Minnesota and east to New York City.[28] From the principal producing centers in Texas, Oklahoma, West Virginia, and Pennsylvania, natural gas is piped to cities in a majority of the states. For both legal and economic reasons state control of this vast industry would be difficult. However, some of the states have regulated the transportation of natural gas. In 1938

[24] Public Act No. 333, 74th Congress, 1st Session, Part II, Secs. 205, 206, and 208.

[25] Public Act No. 333, 74th Congress, 1st Session, Part II, Sec. 207.

[26] Public Act No. 333, 74th Congress, 1st Session, Part III, Sec. 301.

[27] Public Act No. 333, 74th Congress, 1st Session, Part III, Sec. 311.

[28] Moody's "Public Utilities," 1935, see map on p. a51.

Congress passed the Natural Gas Act which has given to the Federal Power Commission jurisdiction over the transportation of natural gas in interstate commerce and the sale in interstate commerce of natural gas for resale for ultimate public consumption.[29]

All rates and charges must be just and reasonable, must be filed with the commission, and must be kept open for public inspection. A natural gas company is forbidden to grant any undue preference or advantage to any person. If the commission finds that any rate or charge is unjust, unreasonable, or unduly discriminatory, the commission shall fix a just, reasonable, or nondiscriminatory rate.[30]

The Federal Power Commission may order a natural gas company to extend or improve its transportation facilities or to establish a physical connection with the facilities of any person or municipality engaged in the local distribution of natural or artificial gas to the public. No natural gas company may abandon any portion of its facilities or any service rendered by means of such facilities without the approval of the Commission.[31]

The control which the Federal Power Commission exercises over accounting is similar to that exercised by other commissions over businesses which are subject to their jurisdiction. The commission may prescribe forms of accounts, may inspect accounts, and may require periodic and special reports.[32]

III. Control of Holding Companies.

One of the outstanding developments in the public utility industry in the period which followed the World War was the rapid concentration of the industry into a few large units. One finds during this period the development of such giant organizations as Electric Bond and Share, Byllesby, Stone and Webster, Doherty, and Insull.[33] Large combinations of utilities present certain advantages both from the point of view of the industry and the public. Large systems can as a rule be financed on better

[29] Public Act No. 688, 75th Congress, 3d Session, Sec. 1.
[30] Public Act No. 688, 75th Congress, 3d Session, Secs. 4 and 5.
[31] Public Act No. 688, 75th Congress, 3d Session, Sec. 7.
[32] Public Act No. 688, 75th Congress, 3d Session, Sec. 8.
[33] Senate Document No. 213, 69th Congress, 2d Session, pp. 168–169.

terms than local units. They may render at minimum costs expert engineering and construction services for those connected with them. They can obtain superior managerial talent to operate various parts of their enterprises. These are advantages which accrue primarily to the public utility industry. However, these advantages should in part be passed on to the public in the form of lower rates or superior service.

Unfortunately, much of the concentration which has taken place, instead of being in the interest of the public or even for the benefit of subsidiary or operating companies, has been primarily financial juggling designed to concentrate control of the industry and to enrich promoters and certain financial interests. The investigation by the Federal Trade Commission of the public utility industry revealed clearly the events which had occurred during the decade that followed the World War. The 80-odd volumes of this report tell an unparalleled story of high finance, of intricate corporate relationships, of practices which were clearly antisocial. Write-ups in the capitalization unaccompanied by corresponding increases in assets were very common. One finds, for example, one write-up resulting from a corporate reorganization which increased the capitalization from $148,000,000 to $547,000,000.[34] One finds tremendous dividends earned on original investments. These were as high as 50 per cent, 60 per cent, and in some cases even more. For example, stock acquired by one holding company for the price of $670,000 paid dividends of $423,000 in one year.[35] The multiplication of holding companies which were superimposed one upon another complicated the financial structures of these large systems and enabled a small group of persons to exercise a dominant control. In one case, five holding companies were imposed upon a group of operating companies.[36]

As a result of the Federal Trade Commission's investigation of the public utility industry, a demand arose for control of these large units. Some states had legislation controlling mergers, consolidations, and purchases of stock or property of public

[34] Senate Document No. 92, 70th Congress, 1st Session, Parts 23 and 24, p. 49.

[35] Senate Document No. 92, 70th Congress, 1st Session, Parts 23 and 24, p. 143.

[36] Senate Document No. 213, 69th Congress, 2d Session, p. 265.

utilities.[37] Several states supplemented this control by regulating the activities of holding companies. Many states, however, made no attempt to control the activities of these large units beyond the regulation of their operating subsidiaries. But state control, even at its best, could not be effective because of the interstate character of these large combinations. For example, the Middle West System, one of the Insull group, controlled utilities extending from Texas to Maine and from North Dakota to Florida.[38] Persons who desired some kind of effective control of holding companies agitated for Federal regulation. In response to this demand, Congress passed the Public Utility Holding Company Act of 1935, which has placed holding companies that control gas and electric utilities under the jurisdiction of the Securities and Exchange Commission.

The activities of these holding corporations which Congress has sought to regulate are of such character as to raise a serious question as to whether or not they can be constitutionally regulated under the commerce power of the Federal government. In the preamble to the act, Congress has indicated what it believes to be the constitutional basis for this legislation. According to the act, public utility companies are affected with a national public interest for several reasons: (1) because their securities are marketed through the mails and other instrumentalities of interstate commerce; (2) because their subsidiaries sell and transport electricity and gas in interstate commerce; (3) because their practices in the control of their subsidiaries affect interstate commerce; and (4) because their activities extending over several states cannot be effectively regulated by the states.[39]

As has been previously stated, the Public Utility Holding Company Act does not cover all public utility holding companies but only those which control gas and electric utilities. The act does seek to bring all of the holding companies of this type under the jurisdiction of the Securities and Exchange Commission by defining a holding company as one which directly or indirectly owns, controls, or holds with power to vote 10 per cent or more

[37] See the article in 81 *Pennsylvania Law Review* 8, "State Control of Consolidation of Public Utilities" by Ford P. Hall.

[38] Senate Document No. 92, 70th Congress, 1st Session, Part 38, map opposite p. 666.

[39] Public Act No. 333, 74th Congress, Sec. 1(a).

of the voting securities of a public utility.[40] The act also brings mutual service companies and so-called affiliates under the control of the commission.[41] Under certain circumstances the Securities and Exchange Commission may exempt holding companies from the operation of the act.[42]

Among the most important provisions of the Public Utility Holding Company Act are those which provide for the registration of holding companies. Any holding company may register by filing with the Securities and Exchange Commission a notification of registration. Within a reasonable period of time after registration the company is required to file with the commission a statement which is to include a copy of the charter and certain other information, such as its organization and financial structure, the rights and privileges of different classes of securities, its directors and officers, bonus and profit-sharing arrangements, options in respect of securities, and a profit and loss statement. Unless a holding company is registered, it is unlawful for it to use the mails or interstate commerce to sell its own securities or the securities of its subsidiaries, to sell goods to or perform services for public utilities, to sell or operate assets for the transmission or distribution of gas or electricity, to own or control with power to vote any security of any subsidiary company, or to engage in any business in interstate commerce.[43]

The registration provisions of the Public Utility Holding Company Act have recently been held valid by the Supreme Court of the United States. The court pointed out that these provisions are separable from the rest of the act and that it is within the commerce power of the Constitution for Congress to provide for the registration of and reporting by these companies.[44]

A registered holding company is forbidden to issue securities, to sell securities, or to exercise any privilege or voting power as a holder of securities without filing with the commission a declara-

[40] Public Act No. 333, 74th Congress, Sec. 2.

[41] An affiliate is defined as any person who directly or indirectly owns, controls, or holds with power to vote, 5 per cent or more of the outstanding voting securities of such specified company. Public Act No. 333, 74th Congress, Sec. 2(11).

[42] Public Act No. 333, 74th Congress, Sec. 3(a).

[43] Public Act No. 333, 74th Congress, Secs. 4(a) and 5.

[44] Elec. Bond and Share Co. v. Securities and Exchange Com. (1938) 303 U. S. 419, 82 L. Ed. 936, 58 S. Ct. 678.

tion containing certain information.[45] Likewise, a registered holding company may not acquire securities, assets, or other interest in public utilities unless the acquisition has been approved by the Securities and Exchange Commission.[46]

A provision which has caused much comment and given rise to much criticism of the act from public utility operators is that which provides for the simplification of holding company systems. One of the criticisms of public utilities arising from the investigation conducted by the Federal Trade Commission was the pyramiding of holding companies and the complicated intercorporate relations among the various parts of the large utility systems. Critics argued that such arrangements were unnecessary, that they were not in the interest of the public or the operating companies, and that they tended to retard rather than to promote efficient operations. Accordingly, Congress has provided that the Securities and Exchange Commission is to examine the corporate structure of every holding company and every subsidiary; the relationships among companies in every system; the property owned or controlled in order to determine the extent to which the corporate structure can be simplified, unnecessary complexities eliminated, voting power fairly distributed, and properties and businesses confined to those necessary or appropriate to the operations of an integrated public utility system. The commission is to require every registered holding company and each subsidiary to take such steps as the commission finds necessary to limit operations to a single integrated public utility system. Under certain circumstances the commission may permit a registered holding company to continue to control one or more additional public utility systems. If the commission finds that the additional system or systems cannot be operated as independent units without the loss of substantial economies which can be secured by the retention of control, that all such systems are located either in one state or in adjoining states, and that the continued combination is not so large as to impair the advantages of efficient operation or effective regulation, the commission may permit the holding company to continue to control additional public utility systems.[47] In the sum-

[45] Public Act No. 333, 74th Congress, Secs. 6(a) and 7.

[46] Public Act No. 333, 74th Congress, Sec. 9.

[47] Public Act No. 333, 74th Congress, Sec. 11.

mer of 1938 the Securities and Exchange Commission started its first proceeding under this part of the act against the Utilities Power and Light Corporation which was reorganizing under Section 77b of the Federal Bankruptcy Act.[48]

Intercompany loans and similar transactions are strictly regulated by the Public Utility Holding Company Act. It is unlawful for a registered holding company *to borrow* or *to receive credit* from any public utility in the same holding company system. It is unlawful for a holding company *to extend credit* or *to lend money* contrary to the rules of the Securities and Exchange Commission. It is also unlawful to pay a dividend on the security of any public utility or to retire, to acquire, or to redeem any security contrary to the rules of the commission.[49]

Another criticism arising from the investigation of public utilities by the Federal Trade Commission was that arising from the selling of equipment to, and performance of services for, utilities by holding companies. The charge was made that public utilities were often required to pay excessive charges for services or equipment and that holding companies used these charges as a device for increasing their profits. The demand arose for legislation which would force holding companies to reveal the details of such transactions and to deal at "arm's length" with their subsidiaries. Accordingly, certain provisions to prevent these abuses were incorporated in the Public Utility Holding Company Act. It is unlawful for any registered holding company to sell goods, to perform services, or to engage in construction work for any associated company which is a public utility. The act also provides that it is unlawful for a subsidiary of a registered holding company or for any mutual service company to sell goods, perform services, or engage in construction work for any associated company except in accordance with the rules and regulations of the commission.[50]

Finally, the Public Utility Holding Company Act provides that holding companies and subsidiaries must keep such accounts and records as the commission deems necessary or appropriate in the public interest or for the protection of investors. Affiliates, mutual service companies, or persons who perform services for

[48] See *Chicago Tribune*, July 21, 1938, p. 21.

[49] Public Act No. 333, 74th Congress, Sec. 12.

[50] Public Act No. 333, 74th Congress, Sec. 13.

public utilities must also keep books and accounts in accordance with the rules and regulations of the Securities and Exchange Commission. All such companies or persons must allow the commission to examine their books and records.[51]

IV. Regulation of Radio Communication.

Radio communication is regulated exclusively by the Federal government. Even though such communication is apparently a kind of commerce, the peculiar nature of it and the impossibility of separating its interstate and intrastate phases necessitate exclusive control by one authority. Division of authority between states and the United States would produce chaos.

Probably no branch of the Federal government affects directly so large a portion of the public as does the Federal Communications Commission. Not only every owner of radio apparatus but also every listener is directly interested in its efforts and achievements. Few of that legion of persons who listen every day to the many varied programs offered by broadcasters realize the numerous complicated and technical problems with which the commission has been confronted during the comparatively brief period of its existence.

Federal regulation of radio may be said to have commenced in 1910. In that year Congress passed a statute requiring steam vessels to have radio transmitting and receiving apparatus for use in case of emergency.[52] It was an act of 1912, however, which formed the basis for Federal control of radio communication until the creation of the Federal Radio Commission in 1927. The Act of 1912 provided among other things that persons could not engage in foreign or interstate radio communication without securing a license from the Secretary of Commerce.[53] Although the act did not specifically mention broadcasting, it was assumed (and this assumption was later substantiated by an opinion of the attorney general) that stations engaged in broadcasting came within the act and that therefore they must secure a license from the Secretary of Commerce before they could lawfully

[51] Public Act No. 333, 74th Congress, Sec. 15.

[52] 36 Stat. L. 269.

[53] 37 Stat. L. 302. For a discussion of the Federal statutes prior to the Radio Act of 1927, see "The Law of Radio Communication" by Stephen Davis, Chap. IV.

operate.[54] Although somewhat of a makeshift, these statutory provisions with amendments sufficed until 1926. In that year the attorney general declared that broadcasting stations were at liberty to use other wave lengths and to operate at other hours than those assigned by the secretary of commerce.[55] This was a decided blow to government regulation. During that same year in a case involving a prosecution for operating on wave lengths and at hours not authorized by the secretary of commerce, a Federal district court construed the statute of 1912 so as to make effective control of radio broadcasting almost impossible. The court declared that to construe the statute otherwise might necessitate a holding that Congress had made an unconstitutional delegation of legislative power, since no definite standard had been fixed to control the secretary of commerce in the exercise of his administrative discretion.[56] As a result of the opinion of the attorney general and this decision of the court, the Department of Commerce was stripped of adequate authority over broadcasting. Many stations jumped to other wave lengths than those which had been assigned. Others refused to confine their transmission to the hours which had been designated by the governmental authorities. Conditions were rapidly becoming chaotic. In commenting upon the situation Commissioner Caldwell declared, "Beginning with August, 1926, anarchy reigned in the ether."[57] To restore order and provide some kind of effective regulation, Congress passed the Federal Radio Act of 1927.

Under the Radio Act of 1927 the Federal Radio Commission was created for one year only. Provision was made for turning over its powers and functions to the Department of Commerce at the expiration of that period of time. However, in 1928 Congress continued the commission for another year and finally in 1929 made it a permanent body. Until 1932, however, the Radio Division of the Department of Commerce still performed a few functions concerning regulation of radio. In 1932 the Radio Division was abolished and its duties were turned over to the Federal Radio Commission. In 1934 the Federal Radio

[54] (1926) 35 Op. Atty. Gen. 126.
[55] (1926) 35 Op. Atty. Gen. 126.
[56] U. S. v. Zenith Radio Co. (1926) 12 Fed. 2d 614.
[57] See Annual Report of the Federal Radio Commission, 1927, p. 10.

Commission was abolished and its functions were taken over by the newly created Federal Communications Commission.[58]

The Federal Communications Act provides for the establishment of the commission as an independent agency of the executive branch of the government and makes the commission primarily responsible for the administration of its provisions. The members are appointed by the President with the advice and consent of the Senate. The term of office for each member is seven years. No commissioner may be financially interested in any company which sells or manufactures radio apparatus or which is engaged in broadcasting.[59]

The Federal Communications Act contains few restrictions upon the persons and corporations which it regulates. The statute is a guide to the regulatory authority rather than a code of duties and restrictions. In this respect it differs from the Interstate Commerce Act, which imposes a number of obligations and restrictions upon the carriers subject to its provisions. Of course the act itself does contain a few restrictions. No stations are to be operated except under license and in accordance with the provisions of the Federal Communications Act. Station licenses or other rights are not to be transferred either voluntarily or involuntarily without the consent of the commission.[60] Persons are forbidden to utter any obscene, indecent, or profane language over the radio.[61] Finally, the act provides that if any licensee allows a candidate for any public office to use its broadcasting facilities, equal opportunity must be afforded to all other candidates for such office.[62]

Even with regard to the powers and functions of the Federal Communications Commission, the act is remarkably free from detail. Congress has enumerated a few powers and functions and then has specified as the principal statutory guide for the commission the vague and indefinite expression, "public convenience, interest, or necessity." If this term is broadly interpreted by the courts, it should allow a considerable latitude for the exercise of administrative discretion. Upon occasion the

[58] U. S. Code, Title 47, Sec. 151.
[59] U. S. Code, Title 47, Sec. 154.
[60] U. S. Code, Title 47, Secs. 307 and 309.
[61] U. S. Code, Title 47, Sec. 326.
[62] U. S. Code, Title 47, Sec. 315.

commission has been requested to define this phrase more precisely but has refused to do so and has pointed out the difficulties of arriving at a complete and satisfactory definition. Furthermore, the commission has stated that eventually this term will have to be defined by the courts and that in all probability this will not be done in one case or in one opinion but by a series of decisions.[63]

One of the most important tasks of the Federal Communications Commission is to consider applications for various kinds of licenses. There are several types of licenses, of which the most important are: construction permits, licenses to operate stations, and operator's licenses. Application may be made also for the modification of permits and licenses.[64] If the commission determines that "public convenience, interest, or necessity" will be served by approval of the application, the license or permit is granted. If approval is not given, the applicant must be notified and given an opportunity for a hearing.[65] No license granted for the operation of a broadcasting station may be issued for longer than three years and no license granted for any other class of station may be issued for more than five years. Renewals may be granted for like periods of time.[66] Licenses may be revoked by the commission on several grounds, among the most important of which are false statements contained in the applications, failure to operate substantially as set forth in the license, or violation of the act or regulations of the commission.[67]

Although the "public convenience, interest, or necessity" is the principal criterion by which the commission is to be guided, a few other provisions of the Federal Communications Act limit the discretion of the commission in granting or refusing a license. In the first place, a station license must contain a condition that the license shall not vest in the licensee any right to operate the station or use the frequencies designated in the license beyond the term thereof or in any manner not authorized therein.[68]

[63] See Annual Report of the Federal Radio Commission, 1928, p. 167.

[64] See Annual Report of the Federal Radio Commission, 1929, p. 53.

[65] U. S. Code, Title 47, Sec. 309.

[66] U. S. Code, Title 47, Sec. 307. In practice, the commission grants licenses for lesser periods of time, such as three months, six months, or a year, depending on the nature of the application.

[67] U. S. Code, Title 47, Sec. 312.

[68] U. S. Code, Title 47, Sec. 309.

The act provides also that a station license shall not be granted or transferred to any alien, to any foreign government, to any company created under the laws of a foreign government, or to any company of which an officer is an alien, of which more than one-fourth of the directors are aliens, or of which more than one-fifth of the capital stock is owned or may be voted by aliens.[69] Furthermore, the commission is to refuse a station license or permit for construction to a station, person, or company which has been adjudged guilty by a Federal court of unlawfully monopolizing or attempting to monopolize radio communication directly or indirectly through the control of the manufacture or sale of radio apparatus, through traffic arrangements, or by any other method. Likewise, the commission is to refuse a permit for construction of a station when the applicant has been found guilty of using unfair methods of competition.[70]

The Federal Communications Act gives to the commission certain other powers and functions in addition to those pertaining to licenses. The act provides that from time to time as "public convenience, interest, or necessity" require it, the regulating authority shall classify radio stations, prescribe the nature of the service to be rendered, assign frequencies, determine the power which each station is to use, determine the time during which each station may operate, regulate the kind of apparatus to be used, determine the location of stations, and make regulations to prevent interference.[71]

The Federal Communications Commission is expressly forbidden to exercise over radio communication any general power of censorship which interferes with the right of free speech.[72] Indirectly the commission must of necessity act as a kind of censor. It is given the power to renew or to refuse to renew licenses. The principle criterion on which applications are judged is the "public convenience, interest, or necessity." If the commission refuses to renew a license because the applicant's programs in the past have not been such as to serve "public convenience, interest, or necessity," it is exercising a kind of censorship. A striking illustration is to be found in

[69] U. S. Code, Title 47, Sec. 310.
[70] U. S. Code, Title 47, Sec. 311.
[71] U. S. Code, Title 47, Sec. 303.
[72] U. S. Code, Title 47, Sec. 326.

the case of *Trinity Methodist Church v. Federal Radio Commission.* In that case a station was operated by a church and used by its minister to "air" his opinions freely. The church filed an application for the renewal of its station license. Many citizens of Los Angeles protested. According to the evidence presented to the commission, the minister had denounced certain religions, attacked persons of particular races, and charged prominent individuals with misconduct and immorality. The commission decided that "public convenience, interest, or necessity" would not be served by the renewal of the license. The language of the court in upholding this action of the commission is interesting:

> If it be considered that one in possession of a permit to broadcast in interstate commerce may, without let or hindrance from any source, use these facilities . . . to obstruct the administration of justice, offend the religious susceptibilities of thousands, inspire political distrust and civic discord, or offend youth and innocence by the free use of words suggestive of sexual immorality, and be answerable for slander only at the instance of the one offended, then this great science, instead of a boon, will become a scourge, and the nation a theatre for the display of individual passions and the collision of personal interests.[73]

In the administration of the above provisions of the Federal Communications Act, the commission has exercised its control over two distinct fields, (1) broadcasting, and (2) other radio communication.

In its control of broadcasting the commission has done a number of things of interest and importance. For one thing, it has designated a band of frequencies from 550 to 1,600 kilocycles as the "broadcast band." Within the "broadcast band" the commission permits operation on every tenth frequency—that is, 550, 560, 570, etc. Such an arrangement gives 106 available frequencies or channels for broadcasting purposes. A few of these have been cleared for the exclusive use of Canadian stations, and certain others are shared between stations in the United States and Canada.[74]

[73] Trinity Methodist Church v. Federal Radio Com. (1932) 62 Fed. 2d 850.

[74] See Gen. Order No. 40 as amended by Gen. Order No. 87, reported in Annual Reports of the Federal Radio Commission, 1928, p. 48; and 1930, p. 19. See also Annual Report of the Federal Communications Commission, 1937, p. 28.

Another thing which the commission has done is to distribute the frequencies in the "broadcast band." The power of the commission to distribute these frequencies is limited by the provisions of the Federal Communications Act. The commission is to make such distribution of broadcasting licenses, bands of frequency, periods of time for operation, and station power among the states and communities so as to provide a fair, efficient, and equitable distribution of radio service to each of these.[75] Of the frequencies or channels in the "broadcast band" many of them have been designated as *clear channels* and assigned to large stations with a power of 5,000 watts or more. As a rule, a station on one of these frequencies has a monopoly of the frequency which has been assigned to it. In a few cases, however, a station must share time with another station which has been given permission to operate on the same channel or frequency. Many frequencies have been designated as *regional channels*. Each of these frequencies has been assigned to several stations operating with a power of 250 watts or more. A few frequencies have been designated as *local channels*. Each of these frequencies or channels has been assigned to many stations operating with small power, 10 watts, 50 watts, and 100 watts. By requiring a sharing of wave lengths and time of operation a great number of positions in this last class have been obtained and distributed to small broadcasting stations in various parts of the United States.[76]

Another thing that the commission has done in its control of broadcasting is to assign the various frequencies to stations. When the commission commenced its work in 1927, it found that the area available for broadcasting was overcrowded and that stations were not properly distributed. It was apparent that changes would have to be made. In some cases the commission was obliged to change the frequencies or hours for operation of stations. In other cases the commission was compelled to eliminate stations altogether. About 700 stations made application for renewal of their broadcasting licenses in 1927. Most of

[75] Public Act No. 652, 74th Congress, 2d Session.

[76] Gen. Order No. 40 as amended by Gen. Order No. 87, reported in Annual Reports of the Federal Radio Commission, 1928, p. 42; and 1930, p. 19. Rules and Regulations of the Federal Radio Commission, 1931, p. 33; Annual Report of the Federal Communications Commission, 1937, pp. 28–29.

these the commission renewed. One hundred and sixty-four stations, however, were required to make a showing that "public convenience, interest, or necessity" required their continuance.[77] As a result of the hearings which followed, 62 were eliminated either through action of the commission or by default.[78] At the present time there are about 700 stations which are licensed to operate on the "broadcast band."

Inevitably a certain number of court cases have arisen from the efforts of the commission to fit stations into its broadcasting scheme. In one of these cases, *American Bond and Mortgage Company v. United States*, a station had been removed from the air by the commission. The owners claimed that this action was arbitrary and that the act was not a valid regulation of interstate commerce. The Circuit Court of Appeals held, however, that Congress had the power under the "commerce clause" to regulate radio communication and that elimination of certain stations operating on the same wave length in the same territory at the same time was necessary to the accomplishment of effective regulation.[79]

Another case dealt with the elimination of a portable broadcasting station. The commission believed that the elimination of this type of station made possible a better use of the limited number of frequencies available for broadcasting purposes, because portable stations could not be spaced geographically and were very apt to interfere with fixed stations on other channels. Accordingly, the commission refused to renew licenses for portable stations and was upheld in its action by the court.[80]

Another case was that of the *General Electric Company v. The Federal Radio Commission.* Station WGY in New York held a broadcasting license which had allowed it unlimited time for operation. Upon application for renewal the commission ordered WGY to share its frequency with KGO of California and forbade it to operate after sunset. This order was reversed by

[77] Gen. Order No. 32, reported in Annual Report of the Federal Radio Commission, 1928, p. 52.

[78] See Annual Report of the Federal Radio Commission, 1928, p. 16.

[79] American Bond and Mortgage Co. v. U. S. (1931) 52 Fed. 2d 318.

[80] Gen. Orders No. 30 and 34, reported in Annual Report of the Federal Radio Commission, 1928, pp. 44 and 45; Carrell v. Fed. Radio Com. (1929) 36 Fed. 2d 117. Objections to this type of station are set forth in the Annual Report of the Commission, 1929, p. 31.

the Federal court on the grounds that the refusal to grant a license with the previous terms was unreasonable and not in the "public convenience, interest, or necessity." The court pointed out that within 100 miles of station WGY there was a large rural and urban population dependent upon this station for reliable radio programs and that to silence this station early in the evening would work a hardship upon the listening public.[81]

Another case of some interest which involved a change in the assignment of a station was that of *The City of New York v. The Federal Radio Commission.* The municipal station of the City of New York known as WNYC had been allowed under an earlier license to operate full time. In 1928 the commission required it to share its time with another station. New York contended that the commission lacked authority to do this because the operation of this station was the exercise of a governmental function. The court stated, however, that the operation of a radio station was the exercise primarily of a private and not a governmental function and that even when used for governmental purposes it was still under the control of the commission. The court held that the rights of radio stations were subject by statute and by express terms of the license to the authority of the commission to limit the operation of stations in the public interest.[82]

The commission has made many other regulations governing broadcasting. For one thing, it requires stations which offer programs of phonograph records or other mechanical reproductions to announce before each offering the exact character of the reproduction. Also, the licensee of each broadcasting station must maintain, except on Sunday, a minimum regular operating schedule of two-thirds of the hours which it is authorized to operate. Furthermore, a licensee is required to announce the call letters and location of the station as often as practicable during the hours of operation, before and after each program, and at least every 30 minutes, except in cases of continuous performances of longer duration. Each station is required to keep a "program log" in which it must enter the various programs and the time of beginning and ending of each. Each station must keep also an "operating log" in which it is required

[81] Gen. Elec. Co. v. Fed. Radio Com. (1929) 31 Fed. 2d. 630.

[82] City of N. Y. v. Federal Radio Com. (1929) 36 Fed. 2d 115.

to enter certain information concerning frequency checks, current checks, and similar matters.[83]

The average person knows of and is more directly interested in the efforts of the commission to control broadcasting. However, much of its time is devoted to other phases of radio communication. The frequencies which are used for radio purposes extend from about 10 kilocycles to more than 400,000 kilocycles.[84] As has been previously stated, the "broadcast band" extends from only 550 to 1,600 kilocycles. This leaves a great number of frequencies below and a great number of frequencies above the "broadcast band" to be assigned and regulated by the commission. The commission has made assignments in the low and high frequencies for many uses. Some frequencies have been assigned to ship stations; many have been set aside for what is called "fixed service," that is, for public or private correspondence between certain points; a few have been allotted for police or fire (marine) use; some have been set aside for amateurs, for radio experimentation, and for television; and others have been cleared for governmental use.[85] In making assignments and regulating the various kinds of radio communication, the commission takes into consideration the provisions of the International Radio Telegraph Convention and the North American Radio Agreement, to both of which the United States is a party.[86]

V. Regulation of Telephone and Telegraph Communication.

For some time prior to 1934 the Federal government regulated certain phases of interstate and foreign telephone and telegraph communication through the Interstate Commerce Commission. In 1934 the jurisdiction over these utilities was enlarged and turned over to the newly-created Federal Communications Commission. The Act of 1934 applies to all *common carriers* by telephone and telegraph engaged in interstate and foreign communication by wire or radio. The term common carrier

[83] See Rules and Regulations of the Federal Communications Commission, Rules 151, 170, 172, 175, and 176.

[84] See Rules and Regulations of the Federal Communications Commission, Sec. 229.

[85] See Gen. Orders No. 7, 85, and 86, reported in Annual Reports of the Federal Radio Commission, 1927, p. 14; and 1931, pp. 18–19. For assignments of frequencies below 550 kilocycles see the Annual Report of the Federal Radio Commission, 1929, p. 14.

[86] See State Department Treaty Series No. 767 and No. 777.

as used in this part of the act, however, does not include those companies engaged in broadcasting.[87] As a result, the Federal Communications Commission has no power to regulate rates, services, discrimination, or consolidation of broadcasting companies.

All charges, practices, classifications, and regulations of common carriers by telephone and telegraph must be just and reasonable. If the commission finds after a hearing or opportunity for a hearing that charges, practices, classifications, and regulations of common carriers by telephone and telegraph are in violation of the act, the commission may prescribe just and reasonable maximum, minimum, or absolute charges, and just, fair, and reasonable practices, classifications, or regulations.[88] Schedules of all charges are to be printed, filed with the commission, and kept open to the public. No change may be made in these except upon 30 days' notice, although under some circumstances changes may be made on shorter notice with the consent of the commission.[89]

The commission has been authorized to make valuations of the property owned by carriers.[90] Likewise, it may require reports and prescribe the forms of any and all accounts.[91]

No carrier may undertake the construction of a new line, make an extension of a line, acquire or operate any line, or engage in transmission until it obtains a *certificate of convenience and necessity* from the Federal Communications Commission. However, no certificate is required for a line within a single state unless it is part of an interstate line. Nor is a certificate required for a local branch or terminal line which does not exceed ten miles in length.[92]

The commission has the power to approve a petition for the consolidation and combination of telephone utilities if it finds that the proposed unification will be advantageous to the persons for whom the service is rendered and in the interest of the public.[93] If the commission approves the consolidation, it issues a *certificate of advantage and public interest*.[94] In one case which involved

[87] U. S. Code, Title 47, Sec. 153.
[88] U. S. Code, Title 47, Secs. 201 and 205.
[89] U. S. Code, Title 47, Sec. 203.
[90] U. S. Code, Title 47, Sec. 213.
[91] U. S. Code, Title 47, Secs. 219 and 220.
[92] U. S. Code, Title 47, Sec. 214.
[93] U. S. Code, Title 47, Sec. 221.
[94] *In re* Application of the Ohio Bell Tel. Co. (1921) 70 I. C. C. 768.

a petition for the acquisition of one telephone company by another, the commission denied the petition because the record did not show that the fair value of the physical properties to be acquired and the earnings of the company would justify the sale price of the properties.[95]

In conclusion, it should be pointed out that the Federal Communications Act makes it unlawful for any carrier to give any undue or unreasonable preference to any person or locality.[96]

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CHAPTER XII

FEDERAL AND STATE CONTROL OF BANKING

For a considerable period of its history the United States has had two banking systems, one controlled by the states and the other by the Federal government. The two systems operate side by side, engage in the same kinds of business, perform essentially the same functions, and yet they are controlled by separate sovereigns. The people of this country are so accustomed to duplication of control that few of them question its advisability or realize that it presents a strange and anomalous situation.

The states derive their authority to control banking from the Tenth Amendment of the Constitution, which declares that the powers not delegated to the United States nor prohibited by it to the states are reserved to the states. Unlike many other powers, the authority over banking is not expressly given to the Federal government by the Constitution. In the well-known case of *McCulloch v. Maryland* the Supreme Court of the United States, speaking through Chief Justice John Marshall, decided that Congress had implied powers which were derived from one or more express powers. Among these implied powers was the authority to establish a national bank.

Government control of banking is more comprehensive in the United States than in foreign countries, and yet it is generally agreed that our banking system compares unfavorably with that of England or even that of Canada. In the matter of bank failures during the past 20 years our record stands in appalling contrast to that of England, which has had no bank failures, and that of Canada, which has had almost none.

Excessive regulation in this country, however, cannot be blamed for the state of our banking system. If anything, we have had too little regulation. Our traditions have been such as to make necessary stringent government control of banking. Banking in the United States has not been "for the select few

whose training, wealth, and social position qualify them." In this country, persons with small sums of money and often little knowledge of finance have entered the banking business. As a result, we have had a highly decentralized banking system. Bank failures are economic catastrophes of the first magnitude, and the government should make every effort to prevent such failures. Furthermore, even our large bankers have not always regarded their positions as positions of trust and have too often engaged in practices which were not only antisocial but in some cases were dishonest. Because of our lack of good traditions, extensive control of banking has been necessary. Banking is a business affected with a public interest. Our Federal and state governments cannot be indifferent to practices which are antisocial. In addition, the power of large banking groups is tremendous. Through financial control they can, and often do, dominate large industrial and commercial corporations. Their decisions and practices may have widespread economic consequences. The government should make some effort to control in the public interest these banking groups which exercise such tremendous financial and economic power.

Governmental control in the United States is exercised in various ways. Sometimes legislatures have imposed definite statutory limitations. Sometimes they have conferred upon administrative agents certain powers of control. For this latter purpose the various states have established banking departments. The Federal government has created three agencies which have some control over banks, the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation.

I. Control of Entry into Service.

Because of the public nature of the banking business it is highly desirable that the government should control the organization and limit the number of such institutions which may operate in a given community and should pass upon the character and competence of persons who are interested in the launching of a banking venture. Many of the difficulties which have been encountered by banks in the United States arise from unnecessary duplication or from improper qualifications of persons who operate such institutions. Although the Federal government

does control to a certain extent the organization of new banking institutions, its efforts have been only partially successful because of state control of state banks. Promoters who could not obtain consent to operate a national bank have sometimes been able to enter the field of state banking.

According to the Federal statute, associations for the purpose of carrying on banking may be formed by five or more natural persons.[1] The capital which is required varies somewhat according to the size of the town or city. If a place has a population of 6,000 or less, the capital may be as little as $50,000, but if a city has a population of 50,000 or more, the capital cannot be less than $200,000.[2] The first step is to file with the comptroller of the currency an application requesting the reservation of a title and stating the location and proposed amount of capital.[3] Upon receipt, the comptroller gives the application to a bank examiner who is to ascertain whether or not conditions justify its approval. In making the investigation the examiner is instructed to give consideration to various factors, such as the character and experience of the organizers and proposed officers, the adequacy of existing banking facilities, the methods, service, and interest rates of banks in the locality, the probable development of the town in which the bank is to be located, and the prospects of success of the proposed enterprise if efficiently managed. If the application is approved, the next steps are the execution of an organization certificate, the drawing up of the articles of the association, and the securing of the necessary subscriptions to the capital stock. The act requires 50 per cent of the capital stock to be paid in cash before a bank can be authorized to commence business, and it permits the balance to be paid in five equal monthly installments. Also a subscription must be made to the capital stock of the Federal Reserve bank of the district in which the proposed bank will be located.[4]

[1] U. S. Code, Title 12, Sec. 21.

[2] U. S. Code, Title 12, Sec. 51.

[3] See "Instructions of the Comptroller of the Currency Relative to the Organization and Powers of National Banks," 1928, p. 1.

[4] U. S. Code, Title 12, Sec. 53. See "Instructions of the Comptroller of the Currency Relative to the Organization and Powers of National Banks," 1928, pp. 5–16. See also "The Office of the Comptroller of the Currency," Service Monograph of the U. S. Govt., No. 38, p. 21, prepared by the Institute for Govt. Research.

When all organization requirements have been fulfilled and the necessary papers filed, the comptroller of the currency, if he is satisfied that the requirements of the law have been met, gives to the association a certificate authorizing the commencement of the business.[5]

The states as well as the Federal government have attempted to control the entry into service of banking corporations or groups. Some of the states, such as Indiana, which have up-to-date banking legislation, exercise a rather stringent regulation. Under the laws of Indiana the banking department has authority to approve or disapprove an application after an investigation of the character and financial standing of the organizers, the qualifications, experience, and character of the officers of the proposed bank, and the public necessity for the financial institution in the community in which it is to be located.[6]

Some states, unfortunately, have had in the past no such stringent entrance requirements and have permitted the organization of banking corporations with a capital as low as $10,000.[7]

II. Examinations and Reports.

Provisions for examination of banks and the making of reports to governmental authorities constitute an important phase of regulation of this kind of business. In no other business is this form of control so important. To examine the financial condition of railroads and to require the making of reports is of secondary interest to the public, which is primarily concerned with the quality of service and the level of rates. In the case of banks, the financial condition is of direct interest to every person who makes use of their facilities. It is not surprising, therefore, that this type of control should play such an important part in both Federal and state regulation of banking.

Every national bank is required to make at least three reports each year. These reports must be published in newspapers in abbreviated form. Banks may be called upon to make special reports whenever in the judgment of the comptroller of the currency such reports are necessary to a full and complete knowledge of conditions. Each bank is required to report the

[5] U. S. Code, Title 12, Sec. 27.

[6] Laws of Indiana, 1933, Chapter 40, Sec. 28.

[7] Compiled Laws of North Dakota, 1913, Sec. 5155.

declaration of any dividend or any excess earnings.[8] National banks must be examined by the comptroller of the currency at least twice each calendar year.[9] No time is fixed for such examination. Examiners visit a bank unannounced, scrutinize carefully its records, and report irregularities to the comptroller of the currency. In order to cover the cost of the examinations, banks pay fees in accordance with their resources.[10] Affiliates of national banks are examined also. State banks which are members of the Federal Reserve System are required to make reports and submit to examinations.

State banks are required to make reports and submit to examinations by their respective banking departments. Although there is much variation from state to state, as a rule these examinations are not so severe as those performed by Federal authorities.

III. Control of Centralization.

The problem of the combination of banking units is one which has been given much consideration and thought by persons interested in banking. One of the weaknesses of our banking system has been the large number of small units with inadequate financial resources. A smaller number of larger units would probably serve our needs better. More centralization of banking with a resulting reduction of weak financial units would probably be in the public interest. Here, as in the case of railroad or public utility consolidations, the government must exercise control in order to prevent unifications which are not in the interest of the public or in order to prohibit financial practices which are antisocial.

Centralization of banking in this country has proceeded in several ways—through branch banking, consolidation, chain banking, and group banking. Both Federal and state governments have exercised varying degrees of control over these diverse methods of centralization.

[8] U. S. Code, Title 12, Secs. 161–164.

[9] U. S. Code, Title 12, Sec. 481.

[10] See "The Office of the Comptroller of the Currency," Service Monograph of the U. S. Govt., No. 38, p. 24, prepared by the Institute for Govt. Research.

Branch banking, although common in such countries as England, was not much resorted to in the United States until after 1920.[11] Legal obstacles undoubtedly prevented a more extensive development. In 1924 the Supreme Court of the United States upheld the validity of a state statute forbidding branch banking. A national bank had established a branch in the city of St. Louis, and the State of Missouri brought suit to determine the authority of the bank to establish such an institution. The Supreme Court declared that the mere multiplication of places where the banking business could be carried on was not the exercise of an incidental power conferred upon banks by the provision of the Federal statute that banks should have all incidental powers necessary to carry on the banking business.[12] In order to give national banks the authority to establish branches, Congress enacted in 1927 a provision declaring that national banks with the consent of the comptroller of the currency could establish and operate branches. As the law now stands, a bank may with the consent of the comptroller of the currency establish and operate branches within the limits of any city, town, or village in which the bank is situated or at any point within the state if such establishment and operation are expressly authorized by law to state banks.[13] Some states forbid branch banking, others allow it to a limited extent, and others permit it on an extensive scale.

Under some circumstances Congress has given to national banks authority to consolidate. Any two or more national banks located in the same state, county, town, or village may consolidate with the approval of the comptroller of the currency on such terms as are lawfully agreed upon by the board of directors and ratified by the vote of the stockholders. All franchises, property, etc., become vested in the consolidated bank without either deed or transfer.[14] Some state laws permit consolidation with the approval of the banking department.[15]

[11] For statistics on branch banking, see "Money and Banking" by William H. Steiner, p. 601.

[12] First National Bank v. Missouri (1924) 263 U. S. 640, 68 L. Ed. 486, 44 S. Ct. 213.

[13] U. S. Code, Title 12, Sec. 36.

[14] U. S. Code, Title 12, Secs. 33–34.

[15] See, for example, Laws of North Dakota, 1931, Chap. 96, Sec. 52.

A distinction is usually made between group and chain banking. Chain banking has been described as the control of the stock of more than one bank by an individual or group. Group banking usually refers to the control of more than one bank by a holding company.[16] The increase in group and chain banking was phenomenal during the period from about 1927 to 1932.[17] During this period such organizations as the Transamerica Corporation, the Northwest Bank Corporation, and others appeared. Undoubtedly one of the reasons for the growth of group and chain banking was a desire to circumvent Federal and state regulatory laws. To some extent the Federal law now controls group banking. For example, holding companies must obtain voting permits from the Federal Reserve Board entitling them to vote the shares of stock of the banks which they control. In making application for such permission, the holding companies must agree to submit to examinations and to publications of statements of their condition. The Federal Reserve Board may revoke a permit for violation of the Banking Act of 1933 or any agreement made thereunder.[18]

IV. Other Restrictions and Regulations.

Both Federal and state governments have imposed a number of other restrictions and regulations upon banks. Chief among these are regulations concerning loans, rates of interest, the holding of real property, reserve balances, declaration of dividends, and the issuing of bank notes.

According to the Federal statutes and some of the state laws, the liabilities of any one person or company to any bank for money borrowed may not exceed 10 per cent of the capital stock actually paid in and unimpaired and 10 per cent of the unimpaired surplus fund of the bank.[19] Under the Federal statute, no national bank may be indebted to an amount exceed-

[16] See the article by the former comptroller of the currency, John W. Pole, in 60 *World's Work* 23 (27), June, 1931.

[17] For an account of the growth of chain and group banking see the articles by John T. Flynn in 63 *New Republic* 141, June 25, 1930 and 85 *Collier's* 20, Jan. 11, 1930.

[18] U. S. Code, Title 12, Sec. 61.

[19] U. S. Code, Title 12, Sec. 84; Laws of Indiana, 1933, Chap. 40, Sec. 195.

ing its capital stock except for a few things, such as notes of circulation, deposits, bills of exchange or drafts drawn against money on deposit to the credit of the bank, and liabilities to stockholders for dividends.[20] Under Federal statutes and some state laws, a bank is forbidden to loan or extend credit to any of its executive officers.[21] Both Federal and state laws limit banks in the making of loans on real property. Commonly a bank may not loan up to more than 50 per cent of the value of such property. As a rule, the property must be located within a certain distance from the bank, usually 50 or 100 miles. A maximum time limit, such as five years, for loans on real property is often fixed.[22]

Many restrictions are to be found with regard to the payment of interest. Members of the Federal Reserve System are not permitted *to pay* interest on any deposit payable on demand. The Federal Reserve Board has the power to regulate the rate of interest which may be paid by member banks on time deposits.[23] On loans which it makes, a national bank may *charge* the rate of interest allowed by laws of the state where the bank is located or one per cent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank of the district. If no rate is fixed by state law, the bank may charge a rate not to exceed seven per cent, or it may charge one per cent in excess of the discount rate.[24]

Federal and state laws usually place limitations upon the power of banks to hold real property. The Federal statute provides that a national bank may hold property which is necessary in the transaction of its business, which has been mortgaged to it in good faith for debts contracted, which has been conveyed to it in the satisfaction of debts contracted in the course of dealings, which has been purchased at sales under judgments held by the bank, or which has been purchased to secure the debts that are due to the bank.[25]

[20] U. S. Code, Title 12, Sec. 82.

[21] U. S. Code, Title 12, Sec. 248k; Laws of Indiana, 1933, Chap. 40, Sec. 200.

[22] U. S. Code, Title 12, Sec. 371; Laws of Indiana, 1933, Chap. 40, Sec. 201.

[23] U. S. Code, Title 12, Sec. 371a.

[24] U. S. Code, Title 12, Sec. 85.

[25] U. S. Code, Title 12, Sec. 29.

Members of the Federal Reserve System are required to maintain certain balances with the Federal Reserve bank. State laws also require certain reserve balances.

An important power which banks enjoy is that of issuing bank notes. Inasmuch as such notes pass readily as money, it is important for governmental authorities to impose stringent limitations and requirements upon banks which issue notes. Congress has placed a 10 per cent tax upon the circulation and paying out of state bank notes.[26] The effect of this tax has been to drive state bank notes out of circulation. On the other hand, Congress has permitted national banks to issue notes but has succeeded in making them so safe that no one hesitates to accept them in ordinary financial transactions. In order to qualify for the issuance of notes, a bank must deposit bonds of the United States with the treasurer of the United States. The bank may then issue notes equal in amount to the par value of the bonds so deposited. Such notes may be issued only in denominations specified by law. They must not exceed in amount the capital stock of the bank. Each bank must maintain in the Treasury of the United States a redemption fund in lawful money equal to five per cent of its note issue. The plates for the printing of such notes are made by the Bureau of Engraving under the direction of the comptroller of the currency. The comptroller also authorizes the printing of such notes and has custody of the plates and dies which are used. Certain things must be printed on the notes. National bank notes are not legal tender but are receivable for all public dues except customs.[27]

Very early in the political history of the United States the Supreme Court in the case of *McCulloch v. Maryland* laid the foundation for the doctrine that national banks may not be taxed by the states. The basis for the doctrine is that the power to tax is the power to destroy, or at least to impede. National banks are in part agents of the Federal government. As such they have public functions to perform and are therefore under the protection of the Federal government. Interference with them cannot be tolerated unless Congress consents. However,

[26] U. S. Code, Title 12, Sec. 562.

[27] U. S. Code, Title 12, Secs. 101–121. See also "The Office of the Comptroller of the Currency," Service Monograph of the U. S. Govt., No. 38, p. 22, prepared by the Institute for Govt. Research.

Congress has permitted the states to tax the real property of national banks and to tax either their shares of stock, net income, or dividends.[28]

V. The Federal Reserve System.

Although the system of national banks which was brought into existence by the Act of 1864 was an improvement over that of state banks, it had certain weaknesses. For one thing, the conditions for the issuance of bank notes were too rigid. The amount outstanding depended to a great extent upon the interest yield of the United States bonds rather than upon the monetary needs of the country. Furthermore, banking in the United States was hampered by a cumbersome and defective exchange and transfer system.[29] To overcome these and other weaknesses the Federal Reserve System was established in 1913.

Under the Federal Reserve System the country is divided into Reserve districts.[30] There are twelve such districts with a Federal Reserve bank in each of the following cities, Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.[31]

At the head of the system, stands the Board of Governors of the Federal Reserve System consisting of seven members who are appointed for terms of fourteen years by the President with the advice and consent of the Senate. Not more than one of the seven members shall be selected from any one Federal Reserve district. In making selections, the President is supposed to give due regard to the various commercial, financial, industrial, and agricultural interests of the country.[32] For obvious reasons, members of the board are subjected to certain restrictions concerning the holding of office or any interest in member banks.[33] The act provides for a Federal Advisory Council which consists of as many members as there are Federal

[28] U. S. Code, Title 12, Sec. 548. See Vol. I, "The Constitution of the United States" by W. W. Willoughby, 2d ed., pp. 159–163.

[29] See "The ABC of the Federal Reserve System" by E. W. Kemmerer, pp. 8–27, in which the author discusses the weaknesses of the banking system prior to the adoption of the Federal Reserve Act.

[30] U. S. Code, Title 12, Sec. 222.

[31] See Annual Report of the Federal Reserve Board, 1927, p. 384.

[32] U. S. Code, Title 12, Sec. 241, as amended by Public Act No. 305, 74th Congress, 1st Session, approved Aug. 23, 1935.

[33] U. S. Code, Title 12, Sec. 242.

Reserve districts. As its name indicates, this council is to act in certain advisory capacities to the Federal Reserve Board.[34]

The Federal Reserve Act sets forth in some detail the powers of the Federal Reserve Board. In general, it has the authority to exercise supervision over the Federal Reserve banks and to some extent over member banks. It may examine the accounts and the affairs of each Federal Reserve bank and each member bank and require such reports as are deemed necessary. One of its important powers is the control over the rediscounting of paper by the various Federal Reserve banks. The board permits Reserve banks to discount voluntarily the paper of other Reserve banks. By an affirmative vote of five members of the Federal Reserve Board, a Federal Reserve bank may be required to discount at rates of interest fixed by the board. The purpose of the provisions pertaining to discounting is to lessen the immobility of reserves which existed in the national banking system before 1913. The board regulates the issuance and retirement of Federal Reserve notes through the comptroller of the currency. The board authorizes national banks to act as trustees and to act in other fiduciary capacities. Also the board may remove or suspend officers of Federal Reserve banks and may even under some circumstances suspend the operation of such banks.[35]

No Federal Reserve bank may have a subscribed capital of less than $4,000,000. National banks must subscribe up to six per cent of their paid-up capital and surplus. Other persons or corporations may subscribe for nonvoting stock up to $25,000. After expenses have been met, a Federal Reserve bank may pay six per cent dividends to shareholders, but net earnings above that must be paid to the United States in the form of a franchise tax.[36]

Many of the powers of Federal Reserve banks are similar to those enjoyed by other banks, namely, the powers to adopt and to use a corporate seal, to make contracts, to sue and be sued, to appoint officers and employees, to prescribe bylaws, and to exercise such other powers as are necessary to carry on the business of banking. In addition, they may discount notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes. This shall not include notes, drafts, or

[34] U. S. Code, Title 12, Secs. 261–262.
[35] U. S. Code, Title 12, Sec. 248.
[36] U. S. Code, Title 12, Secs. 281–285.

bills merely covering investments or those which are issued or drawn for the purpose of carrying on trade in stocks or bonds, except bonds or notes of the United States. The time limit for the maturity of most paper is 90 days. Subject to review by the Federal Reserve Board, each Federal Reserve bank may fix the discount rate for each class of paper. Furthermore, Federal Reserve banks have the power to sell and purchase certain state, Federal, and municipal bonds. They may also receive deposits from member banks and from the government of the United States.[37]

One of the important powers of the Federal Reserve banks is their power to issue currency. As has been previously mentioned, one of the purposes of the establishment of the Federal Reserve System and one which is expressly stated in the act is to obtain greater elasticity of the currency. Under the provisions of the law, currency is supposed to increase as the seasonal or even weekly demand increases. During the Christmas holidays, for example, the public withdraws so much money that the banks ordinarily cannot meet their demands. They turn to the Federal Reserve banks, rediscount eligible paper, and take the proceeds in *Federal Reserve notes.* In turn, a Federal Reserve bank, if its supply is inadequate, makes application to the comptroller of the currency for such notes as it may require.[38] Such a request must be accompanied by collateral equal to the sum of the Federal Reserve notes. Also, Federal Reserve banks must maintain on deposit with the Secretary of the Treasury a sum in gold certificates sufficient in the judgment of the secretary of the treasury for the redemption of these notes. Federal Reserve notes are printed by the government and the plates and dies are kept under the custody of the comptroller of the currency. Federal Reserve notes are obligations of the United States, they are receivable for taxes, customs, and other public dues, and are redeemable in lawful money on demand.[39]

Federal Reserve banks are authorized to issue another kind of currency known as *Federal Reserve bank notes.* These may be

[37] U. S. Code, Title 12, Secs. 341–361.

[38] See "The Federal Reserve System in Operation" by E. A. Goldenweiser, p. 64; see also "The ABC of the Federal Reserve System" by E. W. Kemmerer, p. 52.

[39] U. S. Code, Title 12, Secs. 411–422.

issued against bonds of the United States which are deposited with the treasurer of the United States. Apparently, Federal Reserve bank notes were intended to take the place of national bank notes. They have not done so, however, although a few have been issued for special purposes. Only a few of these notes are outstanding at the present time.[40]

Every national bank is required to be a member of the Federal Reserve System. State banks may become members if they receive the consent of the Federal Reserve Board. In deciding whether to grant or refuse an application, the board must take into consideration the financial condition and the general character of the management of the bank. State banks which become members are required to comply with certain of the requirements imposed upon national banks. They are subject to examination and must subscribe to the capital stock of a Federal Reserve bank. Their membership may be cancelled or voluntarily withdrawn.[41]

All banks which are members of the Federal Reserve System must make reports and subject themselves to examiners approved by the Federal Reserve Board.[42]

VI. The Federal Deposit Insurance Corporation.

The prevalence of bank failures in the United States has resulted in agitation from time to time for some kind of guarantee of bank deposits. Some of the states established deposit guarantee systems but later abandoned them. After the bank holiday of 1933, agitation arose for a national system of deposit insurance. As a result Congress created the Federal Deposit Insurance Corporation.

The management of this corporation is vested in the comptroller of the currency and two persons appointed by the president with the consent of the Senate. Congress has appropriated $150,000,000, which is available for payment by the secretary of the treasury for capital stock of the Federal Deposit Insurance

[40] U. S. Code, Title 12, Secs. 441–445. See also "The Federal Reserve System in Operation" by E. A. Goldenweiser, p. 77. For the amount of these in circulation see Annual Report of the Comptroller of the Currency, 1937, p. 246.

[41] U. S. Code, Title 12, Secs. 282 and 321–331.

[42] U. S. Code, Title 12, Sec. 325.

Corporation. In addition to the capital stock subscribed for by the United States, the law provides that every Federal Reserve Bank shall subscribe to shares of stock in the corporation to an amount equal to one-half of the surplus of such bank on Jan. 1, 1933. Such shares of stock shall be without nominal or par value. Furthermore, such stock shall have no vote and shall not be entitled to the payment of dividends.[43]

The Federal Deposit Insurance Corporation operates a fund which it uses to insure the depositors of all member banks. Under the law the corporation insures all accounts of $10,000 and less for 100 per cent, all accounts between $10,000 and $50,000 for 75 per cent, and all accounts which exceed $50,000 for 50 per cent.[44]

If any member bank closes because of its inability to meet the demands of its depositors, the Federal Deposit Insurance Corporation acts as receiver. The corporation then organizes a new bank to assume the insured deposit liabilities of the closed bank, to receive new deposits, and to perform temporarily certain other banking functions. The corporation then attempts to sell stock of the new bank or endeavors to dispose of its assets and liabilities to another bank. If this cannot be done within two years, the bank is liquidated.[45]

From Jan. 1, 1934 to Oct. 31, 1937, 117 insured banks failed. The Federal Deposit Insurance Corporation promptly met its responsibility by paying all depositors in accordance with the provisions of the Federal Deposit Insurance Act.[46]

VII. Proposed Changes in Banking Control.

Many changes in regulation have been proposed which would correct some of the weaknesses in our present banking system. According to one proposal, the government should own and operate all banks. Those who advocate this contend that banking is so important a business and one which carries with it such tremendous economic power that it should not be entrusted to private persons. It is interesting to note that the Federal

[43] Public Act No. 305, 74th Congress, 1st Session, approved Aug. 23, 1935.
[44] U. S. Code, Title 12, Sec. 264.
[45] U. S. Code, Title 12, Sec. 264.
[46] Annual Report of the Comptroller of the Currency, 1937, p. 22.

government has already found it desirable and in some cases necessary to go into the banking business on an extensive scale. The Postal Savings System, the Reconstruction Finance Corporation, and the Home Owners' Loan Corporation are outstanding illustrations of Federal banking agencies. The Postal Savings System has apparently been established as a permanent banking institution. Whether or not the other two will be permanent agencies, it is impossible to forecast at this time.

Another suggestion proposes the abolition of state banking altogether, thus bringing all banks under the jurisdiction of the United States. Such a move would bring about uniformity of legislation and control. It would eliminate what has sometimes been called a "competition in laxity" between states and the United States. Banks have sometimes been able to play upon this rivalry with disastrous consequences to the public. If Federal regulations have been too stringent, banks have been tempted to enter the state orbit, or vice versa. If all banks were placed under Federal control, Congress might subject them to whatever safeguards it might deem necessary to protect the public. Apparently, the Federal government is gradually gaining control of state banks through the regulations imposed upon members of the Federal Reserve System and banks which are insured by the Federal Deposit Insurance Corporation.

Another proposal would abolish bank holding corporations. It is argued that such corporations tend to defeat effective regulation and really perform no function important to the conduct of sound banking.

How far Congress could constitutionally go in a program of banking control is a debatable question. Thus far the Supreme Court has never failed to uphold the constitutionality of extensions of Federal authority over banking. The Federal government is not given any express authority by the Constitution to control banking, but the courts have held that it has implied power to do so. Furthermore, there is no express limitation or restriction upon Congress except the Fifth Amendment, which prohibits the taking of private property for public use without just compensation. Thus it can be seen that the Constitution itself offers little concrete guidance. The courts if so disposed could justify without great difficulty the adoption by Congress of any of the above proposals. Banks are useful instrumentalities

of the Federal government for many purposes. Also, they are important mediums for the distribution and maintenance of an adequate currency. Furthermore, they are important aids to interstate and foreign commerce. These facts would constitutionally justify extensive control.

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CHAPTER XIII

STATE CONTROL OF INSURANCE COMPANIES

One of the important developments in the United States during the past 75 years has been the growth of insurance. When one pauses to consider the types of insurance which exist, the number of companies offering insurance to the public, and the large group of persons making use of the facilities afforded, one realizes what an important place insurance occupies in our economic and social system.

In a state in which the government would own all property, employ all persons, and otherwise care for the various needs of its citizens, private insurance would have no place since the government would provide against all contingencies. In a system of private ownership and operation such as we have in the United States, with its accompanying uncertainties and its numerous economic hazards, insurance provides a method of protecting the individual by spreading his loss among a large number of persons. Furthermore, certain types of insurance, notably life, have become a very important method of saving and investing.[1]

The intimate relationship of insurance to the public welfare has made government intervention inevitable. Such intervention has taken many forms. A government may operate insurance enterprises, as in the case of the United States government life insurance for ex-service men.[2] A government may compel persons to carry certain types of insurance, as in the case of workmen's compensation insurance, but leave the management and operation to private companies. Or a government may merely control companies engaged in offering the various kinds of insurance which the public finds desirable. This last type of

[1] "Insurance: Its Theory and Practice in the United States" by Albert H. Mowbray; "Insurance" by Saul B. Ackerman; "Insurance Principles and Practices" by Riegel and Loman.

[2] For a discussion of state insurance see "Insurance and the State" by W. F. Gephart.

intervention is much more commonly found in the United States than either of the other two.

The regulation of insurance has been performed by the several states. Gradually the courts have recognized that insurance is sufficiently affected with a public interest to justify somewhat drastic regulations without violating the due process clause of the Fourteenth Amendment.[3] Thus far the Federal government has not attempted to control insurance companies except in the District of Columbia and through the Longshoremen's Compensation Act of 1927. Whether or not the United States can constitutionally regulate the business of insurance is a question which has not been answered. On several occasions the Federal courts have declared that insurance is not commerce.[4] As a result of these decisions one can see constitutional difficulties if Congress should decide that the need for uniformity requires Federal control.

Although there was some state regulation of insurance companies during the nineteenth century, most of the important regulatory legislation was enacted during the twentieth century. The famous Armstrong investigation of insurance companies conducted by the State of New York in 1905 revealed many abuses and undesirable practices on the part of directors and officers of some of the large insurance companies. Large salaries and excessive compensation to officers, manipulation of funds, bribing of state officials, fictitious assets, and excessive litigation over the payment of claims to insured persons were revealed in this investigation, which was conducted by Charles Evans Hughes.[5] The result was a demand for and the enactment of more stringent legislation in New York and other states. Interestingly enough, instead of injuring or working to the detriment of insurance companies, the more stringent legislation has been beneficial. The public has a confidence in insurance at present

[3] German Alliance Ins. Co. v. Lewis (1914) 233 U. S. 389, 58 L. Ed. 1011, 34 S. Ct. 612; O'Gorman and Young v. Hartford Ins. Co. (1931) 282 U. S. 251, 75 L. Ed. 324, 51 S. Ct. 130; Hardware Dealers' Mutual Fire Ins. Co. v. Glidden (1931) 284 U. S. 151, 76 L. Ed. 214, 52 S. Ct. 69.

[4] Paul v. Va. (1869) 8 Wall. 168, 19 L. Ed. 357; New York Life Ins. Co. v. Cravens (1900) 178 U. S. 389, 44 L. Ed. 1116, 20 S. Ct. 962; Hooper v. California (1895) 155 U. S. 648, 39 L. Ed. 297, 15 S. Ct. 207.

[5] See Testimony Taken by the Legislative Insurance Investigating Committee, New York, 1905, Vols. I–X.

which it did not have before 1905. The result has been a tremendous increase in the business of insurance. In fact, the companies which are incorporated in states having the most stringent regulations—New York, Massachusetts, Connecticut, and New Jersey—are among the largest and most reputable of the insurance companies. In the case of insurance, at least, regulation has increased business and paid dividends.

In some respects there is a similarity between the regulation of insurance companies and that of public utilities. In both cases the state controls entry into service. In the case of public utilities the license is in the form of a certificate of convenience and necessity limiting the number of enterprises which may serve a given area; whereas in the case of insurance companies the license is a test of fitness to engage in the business of writing insurance. Both public utilities and insurance companies must submit to examinations by and make reports to governmental authorities. This phase of regulation, however, is of greater importance in the control of insurance companies. Rate regulation is applied to both public utilities and the business of insurance, although the purposes and procedure differ. Likewise, there are prohibitions against discrimination by both insurance companies and public utilities. On the other hand, one finds special kinds of regulation applicable only to insurance. Requirements for the deposit of securities, standardization of policy forms, and control of investments find no parallel in state control of public utilities.

The machinery which the various states employ for the regulation of insurance companies differs from that by which they regulate public utilities, railroads, and motor carriers. As a rule, instead of a board or commission, a department headed by one person is in charge of the regulation of insurance.[6] This may be due in part to the fact that the control of the business of insurance calls for the exercise of more administrative and fewer judicial and legislative functions than the regulation of public utilities or common carriers.

The control which states exercise over insurance can be divided into the following categories: licensing, financial operations, deposit of securities, policy forms, rates, settlement of claims,

[6] "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, Chap. II.

and examinations and reports. Obviously, the regulations vary with the types of insurance, life, fire, casualty, and others.[7]

I. Licensing.

The licensing power is an important and powerful method of control. It has the great advantage of being preventive rather than punitive and of giving notice to persons that certain courses of conduct are not acceptable. Licensing is extensively used by states in attempting to regulate insurance. In general, insurance companies, their agents, and brokers must obtain licenses before they are allowed to operate. These licenses are issued for a comparatively short period of time and must be renewed if the company or agent wishes to continue to engage in the insurance business. As a rule, the commissioner or superintendent of insurance is the official exercising the licensing power.

Nearly every state requires a license before a corporation may engage in the business of writing policies of insurance. This license is commonly referred to as a certificate of authority. The duration of the license varies. Most states provide for annual licenses, although a few states issue indefinite licenses in the case of domestic companies. The license for insurance companies in most states is not a mere device for registration, neither is it merely a method for collecting additional revenues, nor is it a certificate of convenience and necessity designed to limit the number of companies which may engage in the business of writing insurance. The licensing requirement as applied to insurance companies is a real test of qualifications; it is a device to determine whether or not a company should be permitted to engage in this type of business. The grounds upon which a license may be refused vary considerably in the different states. In some states the commissioner of insurance has much discretion. In New York he may refuse to issue a license if such refusal will promote the interests of the people of the state.[8] In South Carolina before granting a license he must be satisfied, among other things, that the company conducts its business in a manner not contrary to the public interest.[9] In other states the com-

[7] "Casualty Insurance" by Clarence A. Kulp, Chaps. XI and XIV; "Principles of Property Insurance" by French E. Wolfe, Chap. XVI; "Life Insurance" by Joseph B. Maclean.

[8] Cahill's Consolidated Laws of New York, 1930, Chap. 30, Sec. 9.

[9] Code of Laws of South Carolina, 1932, Sec. 7944.

missioner of insurance has less discretion but must grant the license if the law has been complied with.

The statutes of many states confer upon the insurance commissioner the power to revoke licenses. Under some of these statutes the commissioner is given much latitude for the exercise of administrative discretion. For example, in New York he may revoke the license of a foreign insurance company when such revocation will best promote the interests of the people of the state.[10] Under other statutes specific grounds for revocation are set forth, such as unsound financial condition, violation of requirements for examination, failure to pay contract obligations to private parties, failure to pay tax obligations to the state, the use of forbidden policy forms, or the use of prohibited methods of doing business.[11]

In addition to the requirement of licenses for insurance companies, many of the states have laws which require licenses for agents and brokers who sell insurance. As a rule, certain conditions must be met before a license is issued; namely, a fee must be paid, a certificate from the company which the agent is to represent must be presented, and certain forms must be filled out and filed.[12] These conditions can hardly be said to constitute a test of qualification or fitness to engage in the business of selling insurance. Sometimes the statutory provision declares that the commissioner must be satisfied that the person is competent and qualified to act as an insurance agent.[13] Occasionally the applicant must take an examination to demonstrate his fitness to engage in the business of selling insurance.[14] As a rule the license is issued for a period of one year. Usually the commissioner has the power to suspend or revoke the license.

II. Control of Financial Operations.

One of the most important phases of governmental control of insurance companies is that which pertains to their financial operations. A financially unsound condition of a gas, electric,

[10] Cahill's Consolidated Laws of New York, 1930, Chap. 30, Sec. 32.

[11] For a list of grounds for revocation commonly found in state statutes, see "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, p. 142.

[12] Code of Laws of South Carolina, 1932, Sec. 7951; Carroll's Kentucky Statutes annotated, Baldwin's 1936 Revision, Sec. 659-2.

[13] Mason's Minnesota Statutes, 1927, Sec. 3352.

[14] Illinois Revised Statutes, 1937, Chap. 73, Sec. 596.

or telephone utility may be reflected in rates or services and thereby operate to the detriment of users of its facilities, but a financially unsound insurance company may be a calamity to those who have made their plans and relied upon the fulfillment of its obligations. Insurance is a device by which persons seek to protect themselves against loss or disaster. If an insurance company is financially unsound and hence unable to meet its obligations, persons are deprived of financial assistance at a time when their need is greatest. It becomes, therefore, the paramount duty of the state in its regulatory program to control the financial operations of insurance companies. The control of financial operations is exercised by the states chiefly through computing the reserve liability, computing the value of assets, controlling investments, controlling expenditures, and approving reorganization, reinsurance, and consolidation.

The reserves of an insurance company are the trust funds required by law to be on hand at all times and enable the insurance company to pay the claims of individuals who have been insured. In the case of a fire or casualty insurance company, the reserve is that portion of the premium income which is held in trust and is not yet earned because the policyholders have not received the full term of protection for which the premium has been collected. It is the result of collecting the price in advance. Although the entire premium is in possession of the insurance company, only the portion which is equivalent to the expired part of the policy actually belongs to the company. The remainder is the unearned premium reserve.[15] The reserve in the case of life insurance results from the payment each year by the policyholder in the earlier years of the policy of a sum larger than necessary to pay the mortality costs. The difference goes into a fund known as the reserve fund and takes care of later years when the mortality cost has risen to exceed the amount of the annual premium.[16]

The maintenance of adequate reserves is very important if an insurance company is to perform the obligation which it has undertaken. Obviously, a state should require all insurance

[15] "Insurance Principles and Practices" by Riegel and Loman, 1921 ed., p. 245.

[16] "Insurance Principles and Practices" by Riegel and Loman, 1921 ed., p. 90.

companies to maintain proper reserves. The statutes of most states contain some reference to computing the reserve liability of the various types of insurance companies and to maintaining proper reserves. Obviously, the reserves required and the methods of computation must vary with the different types of insurance. For example, the Kansas statute provides that the reserves of any insurance company (other than life insurance) having capital stock shall consist of a sum equal to 50 per cent of the premiums received on all unexpired risks that have one year or less to run and a pro rata on all premiums received on risks that have more than one year to run.[17] The Kansas statute also provides that the commissioner of insurance shall value the reserve liabilities of life insurance companies and describes in detail the method which he shall use in doing this.[18]

Closely allied to the problem of reserves is that of valuing the assets or making a valuation of an insurance company. The problem of computing the value of the assets of an insurance company differs from that of making a valuation of a public utility both as to purpose and in procedure. In the case of a public utility, the valuation is made chiefly to determine the rates which should be charged by public utilities for the services which they render. In addition, most of the valuation is of real and tangible personal property or of such intangibles as going value or working capital. In making a valuation of a public utility, accountants and engineers must frequently resort to mere guesswork. In the case of an insurance company, the valuation is made chiefly to determine the financial soundness of the company. Furthermore, the assets are in bonds, first mortgages on real estate, or similar forms of intangible personal property which have a comparatively well-known and definite value. In some states the commissioner is expressly authorized to compute the value of the securities of insurance companies,[19] but in others his power must be implied.[20]

There are two principal types of statutes dealing with the control of investments, those which permit insurance companies

[17] General Statutes of Kansas, annotated, 1935, Sec. 40-234.

[18] General Statutes of Kansas, annotated, 1935, Sec. 40-409.

[19] Cahill's Consolidated Laws of New York, 1930, Chap. 30, Sec. 86.

[20] "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, p. 201.

to invest in all securities which are not prohibited and those which forbid companies to invest in securities not definitely authorized. The statutes of the state of Connecticut furnish an illustration of the former type by forbidding a life insurance company to purchase the stock or bonds of any mining company or the stock of any manufacturing company except a gas or electric utility.[21] The statutes of Kentucky enumerate the investments permitted to insurance companies—government bonds, loans upon improved real estate, bonds of railroads, public utilities, and industrial corporations secured by a first mortgage upon property, and preferred stock which has regularly paid dividends for a period of five years. Under the Kentucky statute, insurance companies other than life may invest to a certain extent in common stock.[22] Because of the speculative risk involved and the difficulty of converting real property into cash, states usually place some limitation upon the investment of insurance funds in real property. For example, in New York, insurance companies may hold only the following real property: that on which is located the principal office building, that which is requisite for the convenient accommodation in the transaction of its business, land mortgaged to the company as security for its loans, land conveyed in satisfaction of its debts, and land purchased at sales upon judgments or acquired under decrees and mortgages made for such debts.[23]

In public utility regulation the control of operating expenses is important since excessive expenditures are reflected in higher rates. If an insurance company maintains sufficient assets to equal its reserve liability, the question naturally arises as to why the state should be concerned with the control of expenditures. Gradually the theory has grown that the interest of policyholders in the surplus of an insurance company should be protected. Excessive salaries or large dividends to stockholders decrease the amounts available as dividends to policyholders. Some states, therefore, have attempted to control the expenses of insurance companies. A New York statute, for example, contains detailed restrictions on expenditures.[24] As a rule, how-

[21] General Statutes of Connecticut, revision of 1930, Sec. 4212.
[22] Carroll's Kentucky Statutes annotated, Baldwin's 1936 revision, Sec. 625.
[23] Cahill's Consolidated Laws of New York, 1930, Chap. 30, Sec. 20.
[24] Cahill's Consolidated Laws of New York, 1930, Chap. 30, Secs. 97–98.

ever, state statutes do not give express powers to the insurance commissioner to regulate expenditures. Nevertheless, commissioners do exercise some control through the broad licensing powers which they have been given.[25]

Sometimes statutory provisions seek to control the transfer of assets in the reorganization, reinsurance, or consolidation of insurance companies. Unless the transfer of assets is carefully guarded, there is a chance that an insurance company in financial difficulties may defraud its policyholders in carrying out transactions of the types just mentioned. In order to prevent this, some states require the approval of the commissioner in cases of reinsurance or consolidation.[26] In other states mere registration of such transactions is sufficient to satisfy the legal requirements.[27] In New York a special liquidation bureau has been formed within the office of the commissioner of insurance in order to facilitate the process of "winding up" companies which are in financial difficulties.[28]

III. Deposit of Securities.

The laws requiring the deposit of securities are supposed to protect the public against the existence of so-called "blue sky" insurance companies. Securities deposited with some governmental official can be checked, counted, and verified with ease and certainty. Promoters of insurance companies must have some assets in order to operate in states which have this requirement. Another reason for this regulation with respect to foreign insurance companies, is that it brings within the jurisdiction of the state certain assets which may be seized through judicial proceedings to pay the just claims of policyholders.

Whatever merit there may be in the requirement for the deposit of securities, it has proved especially burdensome on large companies with offices in many states. If each state demands the deposit of a large block of securities, an insurance company may hesitate to operate in many states.

[25] "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, pp. 209–210.

[26] Code of Ohio, Secs. 9351–9355.

[27] "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, pp. 215–216.

[28] "Insurance: Its Theory and Practice in the United States" by Albert H. Mowbray, p. 442.

In those states which have this requirement an insurance company must deposit with some state official securities or other assets of a fixed minimum value in order to operate. Oftentimes the statutes prescribe in round numbers the value of the securities which must be deposited by the various types of insurance companies. Not uncommonly the amount is set either at $100,000 or $200,000.[29] Sometimes these securities must be deposited with the insurance commissioner, sometimes with the state treasurer, and sometimes with private trustees. Often the statutory provisions specify the kinds of securities which must be deposited.[30] Sometimes a bond in lieu of securities will suffice. As a rule the statutes provide that a company may collect the income from the securities which have been deposited.

IV. Policy Forms.

A policy of insurance is a lengthy and technically worded document. Few persons who buy insurance take the time or the trouble to read in detail the terms of the agreement and few understand the meaning of many of the phrases and exceptions which are to be found in an ordinary insurance policy. The average person who takes out a policy of insurance knows little of the legal pitfalls or the technicalities by which an unscrupulous company can escape its obligations. In order to protect the policyholder, states have enacted legislation designed to standardize the policies of the various types of insurance companies.

Sometimes the legislature has prescribed by statute the exact wording of a policy. Massachusetts has adopted by statute a standard fire insurance policy.[31] This method of control has all of the disadvantages of any direct regulation through legislation. It is rigid and not readily adaptable to new situations.

Sometimes the legislature has given to the commissioner of insurance the authority to prescribe a standard form of policy for certain kinds of insurance.[32] Theoretically this method of

[29] For a list of states and the value of the deposits required, see "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, footnote 3, p. 221.

[30] Code of Iowa, Sec. 8737.

[31] General Laws of Massachusetts, 1932, Chap. 175, Sec. 99.

[32] Vernon's Texas Statutes, 1936, Art. 4908; Georgia Code, 1933, Sec. 56-810.

control has many advantages over direct legislative regulation. Several states adopted statutes allowing the insurance commissioner to prescribe policy forms. Unfortunately, in many places these statutory provisions were declared unconstitutional.[33] To allow the commissioner of insurance to prescribe the policy form without setting standards by which he could be guided or without imposing some limits upon the exercise of his administrative discretion violates the doctrine of nondelegation of legislative power.

More frequently the legislature sets out the provisions which insurance policies must contain or requires that policy forms must be filed, and gives the commissioner the power to approve or disapprove the forms which have been submitted. Variations of provisions of this sort are to be found in most states.[34] The powers given to commissioners of insurance to disapprove policy forms are frequently exercised in the states where they exist.

V. Control of Rates.

State regulation of the rates charged by insurance companies is of more recent origin and has not developed as far as rate control over railroads, gas, electric, or telephone utilities. At first the states were inclined to exercise control by forcing competition. Competition was thought to be the most effective method of safeguarding the public against excessive rates. Companies which combined to fix rates were punished by revocation of their licenses. Gradually, states substituted administrative control for competition. It was not, however, until 1914 that the constitutionality of rate regulation of insurance companies was definitely established. In that year the Supreme Court of the United States held that the business of fire insurance was affected with a public interest and upheld the validity of a statute of Kansas authorizing the superintendent of insurance to fix rates.[35]

In controlling the rates of insurance companies, just as in regulating the rates for other businesses affected with a public

[33] For a discussion of this problem, see "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, pp. 248–258.

[34] General Statutes of Kansas, annotated, 1935, Secs. 40-1109 and 40-420 to 40–421; Illinois Revised Statutes, 1937, Chap. 73, Sec. 755.

[35] German Alliance Insurance Co. v. Lewis (1914) 233 U. S. 389, 58 L. Ed. 1101, 34 S. Ct. 612.

interest, there are three problems: preventing rates which are too high, preventing rates which are too low, and preventing rates which are discriminatory. Furthermore, adequate rate control involves the power to require the filing of rates, the power to approve or disapprove rates, and the power to fix rates. In varying degrees states have conferred upon insurance commissioners the power to regulate the rates of the various types of companies.

The technique of regulating insurance rates varies considerably from that employed in regulating the rates of public utilities. In fact, rate regulation of insurance is in part supervised self-regulation due to the existence of so-called rating bureaus.[36] Instead of preventing cooperation between insurance companies in fixing rates, states are inclined to force cooperation through compulsory membership in rating bureaus maintained by and financed through the insurance companies themselves. For example, the Wisconsin law requires every fire, lightning, windstorm, or sprinkler leakage insurance company to maintain or be a member of a rating bureau.[37] The rating bureau undertakes the difficult and technical problem of fixing rates in the first instance. The laws usually require that rates shall be reasonable and nondiscriminatory and that rates which have been adopted by the rating bureau shall be filed with the commissioner or superintendent of insurance. The commissioner is authorized in some states to approve or disapprove the rates which have been fixed by the rating bureau.[38] Logically, the final step in rate control is the conferring of the authority upon the commissioner of insurance to fix reasonable and nondiscriminatory rates. This has been done in some states.[39]

Although rating bureaus as a device for rate control are open to all of the objections which can be raised against any form of self-regulation, it must be admitted that they have taken a great administrative burden from the state. Rate making for insurance companies is a highly specialized and technical task and calls for a highly paid type of expert. Should the state

[36] "Insurance: Its Theory and Practice in the United States" by Albert H. Mowbray, p. 398.

[37] Wisconsin Statutes, 1937 ed., Secs. 203.33–203.49.

[38] Wisconsin Statutes, 1937 ed., Sec. 203.38.

[39] Wisconsin Statutes, 1937 ed., Sec. 203.39.

attempt to employ the persons necessary to perform adequately the task of establishing rates in the first instance, the cost to the state would be tremendous. It has been estimated that it costs the fire insurance companies of the State of New York $1,000,000 a year to maintain the four rating bureaus which serve that state.[40] It is doubtful whether any state legislative body would be willing to appropriate the sums necessary to employ the technicians required for the proper operation of rating bureaus.

VI. Settlement of Claims.

The settlement of claims against an insurance company is primarily the exercise of a judicial function and as such would seem properly to belong to the courts. In general, it has been so regarded, although there is some tendency to transfer this aspect of control to persons other than judges. For example, some state laws require settlement by arbitrators in case of dispute. A Minnesota statute, for example, requires the insertion into a fire insurance policy of a provision for settlement by arbitration in case of failure of the parties to agree upon the amount of loss.[41]

In some states the settlement of claims by insurance departments has become an important part of their work. Quite generally it is carried on without statutory authority. In the capacity of arbitrator or adjuster of claims the commissioner can perform valuable services to both the insured and the insurer. He can protect the policyholder against an unscrupulous company which is using threats of litigation to defeat just claims. He can also protect the company against policyholders who really do not have a claim against the company. There are also certain advantages to both parties in the settlement of claims by the insurance commissioner instead of the courts. Legal technicalities and formalities are brushed aside. Besides, the expense incidental to a settlement by the commissioner is insignificant compared with the expenses of court litigation. Finally, the commissioner is in a better position to compromise differences than is a court.

[40] "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, p. 279.

[41] Mason's Minnesota Statutes, 1927, Sec. 3512.

VII. Examinations and Reports.

In the regulation of public utilities or railroads, the requiring of periodic reports and the allowing of the examination of books and records is merely an adjunct to other phases of control. Such reports and examinations are of value to the commission as a device for making effective the control of rates, abandonment of service, consolidation or merger, and the issuance of securities.

Requiring reports and conducting examinations is a very important phase of state control of insurance. The question in which policyholders are most interested is whether or not an insurance company will pay their claims in case of loss. Requirements for reports and examinations are an important method of assuring a satisfactory financial condition for insurance companies.

State statutes usually require that annual reports must be filed with the commissioner of insurance. As a rule the time for making the report is fixed in the statute. Contents of the reports vary with the different types of companies, but as a rule they show in detail the income and disbursements for the year and the assets and liabilities of the company. Sometimes the statutes prescribe the contents of reports and sometimes the commissioner is given the power to prescribe the contents.

In every state the commissioner is authorized to examine or cause examinations to be made of insurance companies. Many states require the commissioner to make examinations at certain regular intervals, commonly three years. Many states give the commissioner authority to conduct special examinations. Under the statutes of some states this may be done whenever the commissioner determines that it is prudent or necessary. Under the statutes of other states nothing is said about the grounds upon which a special examination may be made. Under the statutes of still other states a special examination may be made only upon some definite grounds as, for example, when the commissioner doubts the solvency of an insurance company.

Invariably the cost of an examination must be paid by the company. Obviously, this may constitute a considerable financial burden to large companies which operate in several states. In order to lighten the expense, many states expressly authorize the commissioner to accept, in place of his own examination, a certificate of examination of the insurance department of another state. Another method of avoiding duplication of examinations

is cooperative examination by the insurance departments of several states. Although there is some difference in the requirements of different state laws with regard to examinations, there is sufficient uniformity in the information which is required to make joint examination feasible.[42]

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[42] "The Insurance Commissioner in the United States" by Edwin Wilhite Patterson, pp. 368–370.

CHAPTER XIV

FEDERAL CONTROL OF THE COAL INDUSTRY

The regulation of the bituminous coal industry is of recent date, although the problems which have necessitated this control have existed for a considerable period of time. The need for regulation arose neither from monopolistic practices nor from price fixing which was detrimental to the public, but as the result of economic conditions in the coal industry itself. The mining and distribution of coal have suffered tremendously from the severe competition offered by other industries. The rapid growth in the use of electricity, oil, and natural gas as sources of energy has had disastrous consequences in the coal industry, resulting in overproduction and ruinous competition among the mine owners and widespread unemployment among the mine workers.

I. Early Attempts at Regulation.

For some time before the passage of the present act, known as the Bituminous Coal Act of 1937, both producers and workers had sought ways of controlling the industry and improving the economic conditions of both capital and labor. One of the first of these efforts was the formation in 1929 of an organization known as Appalachian Coals Incorporated. This was an organization of producers of bituminous coal in Virginia, West Virginia, and Tennessee, who created a selling agency to sell all the coal they produced. The agency agreed to sell coal at the best prices which could be obtained and if all the coal could not be sold, the agency agreed to apportion orders upon a certain basis. The government of the United States contended that this plan violated the Sherman Antitrust Law because it eliminated competition and gave the selling agency control over the price of bituminous coal in certain markets. Accordingly the Federal government brought suit against Appalachian Coals Incorporated. The Supreme Court of the United States decided that this organiza-

tion was not violating the Sherman Act. The court pointed out that the economic condition of the coal industry had been deplorable and that certain competitive practices within the industry had aggravated this condition. The court found that there was no intent to monopolize or to restrain trade but rather a sincere effort on the part of members of the coal industry to eliminate certain abuses and to attempt to improve their economic condition. Furthermore, the court did not find that the organization was in a position to fix prices in the bituminous coal industry, but on the contrary it had to face active competition from producers of coal in other areas.[1]

The passage of the National Industrial Recovery Act in 1933 marked the beginning of the second stage in the attempt to control the bituminous coal industry. Under the National Industrial Recovery Act, industries were permitted to adopt codes of self-regulation which were subject to the approval of and enforceable by the Federal government. The bituminous coal industry adopted a code which was approved by the National Recovery Administration. This code fixed maximum hours and minimum wages for miners, eliminated child labor, authorized employees to organize and to bargain collectively, and adopted a number of other regulations which were designed to improve the conditions of labor in the mining industry. The Bituminous Coal Code also contained a number of prohibitions against unfair practices, such as the selling of coal under fair market prices that were fixed by certain market agencies established by the code.[2] The Bituminous Coal Code was more extensive, not only in the types of control imposed on the coal industry but also in geographic extent, than the previously-mentioned Appalachian Coals Incorporated. In 1935 the National Industrial Recovery Act was declared unconstitutional and as a result the Bituminous Coal Code became inoperative.[3]

The disappearance of the coal code did not solve the economic problems of the industry or eliminate the necessity for regulation.

[1] Appalachian Coals Inc. v. U. S. (1933) 288 U. S. 344, 77 L. Ed. 825, 53 S. Ct. 471.

[2] "Code of Fair Competition for the Bituminous Coal Industry," Articles III, V, and VI.

[3] Schecter Poultry Co. v. U. S. (1935) 295 U. S. 495, 79 L. Ed. 1570, 55 S. Ct. 837.

Urged by employees and a large section of employers in the coal industry Congress enacted new legislation which was known as the Bituminous Coal Conservation Act of 1935. This act imposed a tax of 15 per cent on the sale of coal at the mines. If any producer accepted the code for which the act provided and acted in compliance therewith, he was entitled to a drawback of 90 per cent of the amount of the tax. A commission was established and authorized to formulate an elaborate agreement known as the Bituminous Coal Code. The country was divided into 23 districts, each with a district board. Minimum prices were to be established in each of these districts. Employees were given the right to organize and bargain collectively. Furthermore, if wage agreements and maximum hour agreements were approved by representatives of more than two-thirds of the annual tonnage production of a district and a majority of the mine workers of the district, such wages and hours were to be binding on all code members in that district.[4] In a suit attacking the minimum wage and maximum hour provisions, the act was declared unconstitutional by the Supreme Court of the United States in 1936 on the grounds that coal mining was not commerce and that the fixing of minimum wages and maximum hours was therefore not a valid regulation by Congress under the commerce clause of the Constitution.[5] The court in this case did not pass upon the validity of the price-fixing provisions but held that the invalidity of the labor provisions carried with it the invalidity of the provisions dealing with prices.

II. The Bituminous Coal Act of 1937.

In 1937 Congress made another attempt to deal with the problems of the coal industry by passing the Bituminous Coal Act of 1937. This act followed the pattern of the Act of 1935 but omitted the wage and hour features to which the Supreme Court had objected in declaring the Act of 1935 unconstitutional. Under the Act of 1937 a National Bituminous Coal Commission has been established in the Department of the Interior. Each of its seven members is appointed by the President with the

[4] Public Act No. 402, 74th Congress, 1st Session, approved Aug. 30, 1935.

[5] Carter v. Carter Coal Co. (1936) 298 U. S. 238, 80 L. Ed. 1160, 56 S. Ct. 855.

advice and consent of the Senate for a period of four years. Two members of the commission must have had experience as bituminous coal mine workers and two must have had experience as producers.[6]

This act imposes a tax of 19½ per cent of the sale price of the coal at the mine. However, the sales of any producer who is a member of the code for which the act provides are exempt from the tax so long as he remains a code member.[7]

The act provides for the establishment of a code which is promulgated by the commission and which is designated as the Bituminous Coal Code. This code has several parts, many of which resemble those found in the coal code which was adopted under the National Industrial Recovery Act.

Twenty-three district boards are to be organized, consisting of not less than three or more than 17 members. Each district board is to propose minimum prices for kinds, qualities, and sizes of coal produced in its district and to propose reasonable rules and regulations incidental to the sale and distribution of coal. District boards are also to coordinate minimum prices in common consuming market areas and submit these prices to the commission for approval. The minimum prices are to reflect as nearly as possible the relative market value of the various kinds of coal, are to be just and equitable as between producers within the district, and are to give due regard to the interests of the consuming public. The commission is to have power to prescribe minimum and maximum prices and marketing rules and regulations for code members. Maximum prices of coal may be established by the commission if they are necessary to protect consumers. No coal may be sold or offered for sale at a price below the minimum and above the maximum which has been set.[8] In December, 1937, the commission proposed a schedule of minimum prices for the sale of bituminous coal.[9] So much objection was raised by the various persons affected that the commission cancelled this schedule and started work on a new schedule.[10]

[6] Public Act No. 48, 75th Congress, 1st Session, Sec. 2.
[7] Public Act No. 48, 75th Congress, 1st Session, Sec. 3(b).
[8] Public Act No. 48, 75th Congress, 1st Session, Sec. 4.
[9] See *Federal Register*, Dec. 3 and Dec. 21, 1937.
[10] See New York Times, February 24, 1938, p. 8.

In addition to establishing machinery for the fixing of maximum and minimum prices, the Bituminous Coal Code which is provided for by the Act of 1937 declares that certain unfair methods of competition are violations of the code. Some of these prohibit discrimination which might result from the prepayment of freight charges or the adjustment of claims. Others forbid the unauthorized use of trade-marks, trade names, or slogans. Others forbid such practices as misrepresentation, commercial bribery, or inducing breach of contract.[11]

The question naturally arises as to why the above provisions are included in a code which is to be adopted by the commission instead of enacted directly by statute. Perhaps the framers of the Bituminous Coal Act thought that because regulation through codes is self-regulation in part, code provisions would receive better cooperation from the coal industry than outright statutory restrictions. It is true that elements of self-regulation are to be found in the organization and powers of the district boards established by the coal code. In theory, too, only those producers who so desire sign the code. The voluntary element, however, is mere fiction, because the tax of 19½ per cent is so high that most producers are compelled to sign through economic necessity. Also code control is more flexible, supposedly, than statutory regulation. The flexibility here, however, is more shadowy than real since the Bituminous Coal Act specifies most of the provisions which are to be contained in the coal code.

The Bituminous Coal Commission is charged with the task of making certain studies and reports. It is to investigate the economic operations of the mines with the view to the conservation of natural resources; it is to study the safe operation of the mines for the purpose of minimizing the working hazards; it is to investigate the problem of marketing in order to lower distributing costs to the consumers; and it is to study necessity for the control of production and allotment of output to districts and producers within the districts.[12]

Although there are no provisions regarding hours and wages because of the constitutional objections raised by the Supreme Court, the Bituminous Coal Act does contain a few provisions with regard to the treatment of labor. The act states that

[11] Public Act No. 48, 75th Congress, 1st Session, Sec. 4.

[12] Public Act No. 48, 75th Congress, 1st Session, Sec. 14.

employees of coal producers shall have the right to organize and bargain collectively. Furthermore, no employee is to be required as a condition of employment to join any association of employees of which the producer has direction or control.[13]

References

Appalachian Coals Inc. v. U. S. (1933) 288 U. S. 344, 77 L. Ed. 825, 53 S. Ct. 471.

"Code of Fair Competition for the Bituminous Coal Industry," Arts. III, V, and VI.

Carter v. Carter Coal Co. (1936) 298 U. S. 238, 80 L. Ed. 1160, 56 S. Ct. 855.

Public Act No. 48, 75th Congress, 1st Session, approved Apr. 26, 1937.

[13] Public Act No. 48, 75th Congress, 1st Session, Sec. 9.

CHAPTER XV

THE CONTROL OF BUSINESS UNDER THE ANTITRUST LAWS

During the period which preceded the enactment of the Sherman Antitrust Law of 1890, a rapid and tremendous concentration had taken place in certain fields of commerce and industry. The outstanding example was that of the Standard Oil combination, which by 1879 had secured control of about 90 per cent of the oil-refining capacity of the United States.[1] The tactics employed by some of the large combinations in securing for themselves a dominant position were such as to arouse the fears and antagonism of the public. The securing of railroad rebates and the engaging in other unfair practices probably led to the feeling that these combinations had grown and prospered, not because of any inherent superiority in methods or products, but because of tactics which were unfair to rivals and inimical to the interests of the public. Furthermore, the almost complete monopoly which some combinations had acquired undoubtedly led the public to fear the possible results of such concentration of power and wealth. By 1888 antagonism toward trusts had manifested itself to such an extent that the four important political parties, Democrats, Republicans, Prohibitionists, and Union Laborites embodied planks in their respective platforms denouncing and expressing opposition to combinations and trusts.[2]

Prior to the enactment of the Sherman Law the Federal government had no legislation prohibiting monopoly or restraint of trade. Such restrictions as existed were to be found at common law or in the statutes of the various states. Neither the common

[1] See "The Trust Problem in the United States" by Eliot Jones, p. 52.

[2] See "The Trust Problem" by Jenks and Clark, 4th ed., p. 244; See also "The Federal Trust Policy" by John D. Clark, p. 27, in which the author states that the extent of the popular agitation for the enactment of the Sherman Law has been greatly overemphasized.

law of England nor that of the several states of the United States had developed very extensive restrictions upon the activities of persons desirous of securing a monopoly or combining in restraint of trade. It is true that at common law the courts had developed the rule that unreasonable contracts in restraint of trade were invalid.[3] But they had not developed the rule that a person injured by a combination of other persons was entitled to damages.[4] Neither had they developed the rule that it was a criminal offense at common law to monopolize, combine, or to make a contract in restraint of trade.[5] In several states, antitrust statutes had been enacted before the date of the Sherman Law.[6] Although these materially strengthened the common law, they would hardly have been sufficient without the aid of a Federal statute to eradicate the supposed evils of monopoly and restraint of trade, as large combinations were ignoring state boundaries and spreading their activities from coast to coast. Realizing this, Congress fortified state legislation by the enactment of the Sherman Antitrust Law of 1890. In 1914 Congress sought to strengthen the Sherman Act by passing the Clayton Act and the Federal Trade Commission Act. Subsequent legislation, notably the Webb-Pomerene Act of 1918, the Transportation Act of 1920, and the Capper-Volstead Act of 1922, weakened the antitrust laws by making a series of exceptions.

I. The Sherman Act.

1. *Provisions.*

Section 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal. Every

[3] For a statement of the common-law doctrine in England, see "Law of Contracts" by Anson, 16th ed., p. 251. For a discussion of some early American cases, see "The Trust Problem in the United States" by Eliot Jones, p. 302.

[4] See, for example, the English case, Mogul Steamship Co. v. McGregor (1889) 23 Q. B. D. 589; in the House of Lords (1892) A. C. 25.

[5] See "Combinations in Restraint of Trade" by W. W. Thornton, p. 87. "At common law contracts restraining trade or limiting competition were not criminal. They were simply unenforceable in the courts."

[6] For a list of the states which had antitrust statutes before the Sherman Act, see "The Trust Problem" by Jenks and Clark, 4th ed., p. 245.

person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding $5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court. . . .

Section 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding $5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.[7]

In addition to the two sections quoted above, the Sherman Act contains provisions concerning monopoly and restraint of trade in the territories and provisions dealing with the jurisdiction of the Federal courts.

2. *Judicial Interpretation.*

There is no more vague and contradictory field of control of business than that covered by the antitrust laws and their judicial interpretation. The entire subject is a vast jungle of inconsistencies and uncertainties. The reasons for this are not hard to find. In the first place, the Sherman Law itself, because of its vagueness, offers little guidance to the courts. Such terms as "restraint of trade" or "attempt to monopolize" give little in the way of concrete assistance to the judiciary.[8] In the second place, the doubtful economic thesis which the Sherman Law expounds, that every combination, contract, or attempt to monopolize commerce among the states is vicious and should be made illegal, has proved untenable. By court decision, by legislative enactment, and by executive inaction the government has mitigated the sweeping provisions of the Sherman Act, thus providing a series of exceptions which are logically hard to reconcile. As a result, it is well-nigh impossible to trace a consistent thread of judicial logic through the numerous conflicting decisions. Despite the difficulties to be encountered, an effort will be made to enumerate and discuss some of the rules which

[7] U. S. Code, Title 14, Secs. 1 and 2.

[8] See the article by J. T. Young, *Annals of the American Academy of Political and Social Science*, January, 1930, p. 171.

the courts seem to have laid down in interpreting the Sherman Act.

At the outset it should be remembered that the Sherman Law is designed to protect interstate and foreign commerce, but it is not designed to protect commerce which is intrastate or transactions which are not commerce.

In the case of *Knight v. United States* the Supreme Court emphasized this point by holding that a gigantic combination of companies engaged in the refining of sugar had not violated the Sherman Act because the companies were engaged in manufacturing and manufacturing was not commerce.[9] Since the government failed to prove any intent to restrain interstate commerce or any restraint upon such commerce, the combination was held not to have violated the Sherman Act despite the fact that it controlled plants producing 98 per cent of the total amount of sugar refined in the United States.[10] In another case the Federal League Baseball Club of Baltimore sued the National League, the American League, and others for damages under the Sherman Act, alleging that the defendants had conspired to monopolize the baseball business in violation of the Sherman Antitrust Law. The Supreme Court held, however, that the business of giving exhibitions of baseball was not interstate commerce within the meaning of the act.[11]

It is not necessary that the parties who are being accused of a violation of the Sherman Law be, themselves, engaged in interstate commerce. The court will sustain a cause of action against them if the plaintiff can prove that they are interfering with or restraining the flow of commerce from state to state. Therefore it was held that labor leaders who were promoting boycott activities which were interrupting the flow of commerce were violating the Sherman Law.[12] More recently the Sherman Law was successfully invoked against Chicago candy "racke-

[9] United States v. E. C. Knight Co. (1895) 156 U. S. 1, 39 L. Ed. 325, 15 S. Ct. 249.

[10] See the comment on the Knight case by Chief Justice Taft in his book, "The Anti-trust Act and the Supreme Court," pp. 54–60, where he contends that the government in all probability could have proved a violation of the Sherman Act had its case been properly prepared and presented.

[11] Federal Base Ball Club v. National League (1922) 259 U. S. 200, 66 L. Ed. 898, 42 S. Ct. 465.

[12] Loewe v. Lawlor (1908) 208 U. S. 274, 52 L. Ed. 488, 28 S. Ct. 301.

teers" who, although not engaged in interstate commerce, were by threats and coercion restraining and interfering with commerce in candy between states.[13]

Another thing to be remembered is that not all monopoly and restraint of trade is illegal under the Sherman Act, but only that which is unreasonable. It is true that the Sherman Anti-trust Law expressly declares that *every* contract, combination, or conspiracy in restraint of trade is illegal and that *every* person who shall monopolize or attempt to monopolize trade or commerce shall be guilty of a misdemeanor. At first the statute was strictly interpreted. In the case of *United States v. Trans-Missouri Freight Association* the Supreme Court declared emphatically that all combinations in restraint of trade were illegal.[14]

In subsequent decisions, however, the Supreme Court modified this declaration. In the Standard Oil case and also in the American Tobacco case the court enunciated the so-called "rule of reason," that not all combinations in restraint of trade were illegal, but only those which were unreasonable.[15] In reaching this conclusion, the Supreme Court pointed out that it was following the common law and that such interpretation was in accordance with the intentions of the framers of the Sherman Act. It is true that Senator Sherman in the course of debates on the measure in Congress stated that his bill did not declare any new principle of law but merely applied old and well-recognized rules of the common law.[16] Despite this statement, it is true that the law did make several radical departures from the common-law doctrine by adding criminal provisions, provisions for damages, and provisions for injunctions.

In view of these changes in the common law and the sweeping statements of the statute, the arguments of the court in the Standard Oil and American Tobacco cases do not appear particularly convincing. One is led to suspect rather that the court was beginning to recognize that in the natural course of economic

[13] Boyle v. U. S. (1930) 40 Fed. 2d 49.

[14] U. S. v. Trans-Missouri Freight Ass'n (1897) 166 U. S. 290, 41 L. Ed. 1007, 17 S. Ct. 540.

[15] Standard Oil Co. v. U. S. (1911) 221 U. S. 1, 55 L. Ed. 619, 31 S. Ct. 502; U. S. v. American Tobacco Co. (1911) 221 U. S. 106, 55 L. Ed. 663, 31 S. Ct. 632.

[16] See the speech of Senator Sherman, *Congressional Record*, 51st Congress, 1st Session, Vol. 21, p. 2456.

development, combinations were inevitable and that many such combinations might be beneficial rather than inimical to public welfare. In any event, the enunciation of the "rule of reason" marked a most important stage in the interpretation of the Sherman Act.

In trying to determine whether or not there has been a violation of the Sherman Act, the courts take into consideration a number of factors. Among the most important of these are the form of the combination, the intent of the parties, the extent of control, the tactics of the parties in securing or maintaining control, the effect on prices, and the benefits to the public.[17]

Although the form of a contract or combination is by no means the only factor which the courts consider, judges in a few cases have emphasized form in arriving at their decisions. It appears, for example, that a restraint of trade or monopoly resulting from mergers, consolidations, or the formation of holding companies is more readily condoned by the courts than restraint of trade or monopoly resulting from agreements or understandings of independent industrial or commercial units.[18] Also, form is sometimes important in determining whether or not *contracts* are in restraint of trade. For example, the courts have declared that ordinary contracts fixing resale prices violate the Sherman Law; whereas *agency* contracts achieving the same results do not.[19]

Even though some forms of combinations or agreements enjoy greater immunity under the Sherman Act than others, probably

[17] See the article "Industrial Mergers and the Anti-trust Laws" by Milton Handler, 32 *Columbia Law Review* 179, in which the author discusses the question of the factors which the courts take into consideration in determining the legality of corporate mergers, etc.

[18] Compare the case of U. S. v. U. S. Steel Corp. (1920) 251 U. S. 417, 64 L. Ed. 343, 40 S. Ct. 293 with American Column and Lumber Co. v. U. S. (1921) 257 U. S. 377, 66 L. Ed. 284, 42 S. Ct. 114.

See also the footnote on page 912 of *Michigan Law Review* for May, 1931.

In the case of U. S. v. American Linseed Oil Co. (1923) 262 U. S. 371, 67 L. Ed. 1035, 43 S. Ct. 607, the court declared, "In the absence of a purpose to monopolize, or the compulsion that results from contract or agreement, the individual may certainly exercise great freedom; but concerted action through combination presents a wholly different problem and is forbidden when the necessary tendency is to destroy the kind of competition to which the public has long looked for protection."

[19] Compare Dr. Miles Medical Co. v. Park and Sons Co. (1911) 220 U. S. 373, 55 L. Ed. 502, 31 S. Ct. 376 and U. S. v. Gen. Electric Co. (1926) 272 U. S. 476, 71 L. Ed. 362, 47 S. Ct. 192.

no combination or agreement because of its form enjoys complete immunity. This seems to be borne out by the following statement of the Supreme Court of the United States:

> . . . the generic designation of the 1st and 2nd sections of the law, when taken together, embraced every conceivable act which could possibly come within the spirit or purpose of the prohibitions of the law, without regard to the garb in which such acts were clothed.[20]

Persons and corporations have used many forms in order to achieve a combination or monopoly. Trusts, holding corporations, pools, contracts, mergers, consolidations, trade associations, and even mere understandings have been condemned as violations of the Sherman Act. At one time or another, combinations resulting from each of these have been declared invalid under the Sherman Antitrust Act.

Another factor which has been much emphasized in deciding cases arising under the Sherman Act is the intent of the parties. It is difficult to say just why intent should play so important a part. Perhaps the courts have been influenced by the concept of malice as an essential element in the common-law tort of conspiracy.[21] At any rate, this emphasis upon intent has added one more element of uncertainty to the Sherman Law, for intent is an extremely difficult thing to discover. Obviously, it must be determined largely by such objective evidence as the overt acts of the parties. Furthermore, in making use of intent in connection with the antitrust laws, the courts are seeking to apply legal ideas and legal criteria to economic situations. The concept of intent is much employed in law but has no particular economic significance. It may be important to know whether or not an accused person intended to kill another, but so far as economic consequences are concerned it matters little whether a certain person intended to restrain or monopolize commerce.

Another factor is the extent of the control of the parties who have combined or attempted to monopolize commerce. The more extensive the control, the more carefully the courts will scrutinize the combination. Undoubtedly the extensive con-

[20] U. S. v. American Tobacco Co. (1911) 221 U. S. 106, 55 L. Ed. 663, 31 S. Ct. 632.

[21] See the English case of Quinn v. Leathem (1901) A. C. 495.

trol of the defendants in the Standard Oil and American Tobacco cases had much to do with the findings that the defendants were guilty of a violation of the Sherman Act.[22]

However, the mere size of a combination or the fact that it occupies a predominant position in the field does not of itself constitute a violation of the Sherman Act.[23] This is especially true when a combination has for its purpose a more economical means of production or distribution. For this reason the so-called *vertical* combinations—that is, combinations of noncompeting units which unite a series of successive steps in the production or distribution of a product—have been able to escape more successfully the charges of violation of the Sherman Act than have *horizontal* combinations—that is, combinations of competing units. In the former case, the evidence points to an intention to secure efficiency of operation rather than an intention to restrain or monopolize trade.[24] The case of *United States v. Winslow* is a good illustration.[25] In that case the Supreme Court upheld the validity of a consolidation which involved several companies, one of which controlled 60 per cent of all *lasting* machines made in the United States, another controlled 80 per cent of all *welt-sewing* and *outsole-stitching* machines, and a third controlled 70 per cent of all *heeling* machines and 80 per cent of all *metallic fastening* machines. According to the court, this combination was on the surface merely an effort to secure greater efficiency. Since the various units did not compete with one another, the court could not see why the combination was any more illegal than its component parts.

Even a large horizontal combination does not constitute a violation of the Sherman Law merely because of its size.[26] This

[22] Standard Oil Co. v. U. S. (1911) 221 U. S. 1, 55 L. Ed. 619, 31 S. Ct. 502; U. S. v. American Tobacco Co. (1911) 221 U. S. 106, 55 L. Ed. 663, 31 S. Ct. 632.

[23] See the publication of the National Industrial Conference Board, "Mergers and the Law," p. 84.

[24] See the article by J. George Frederick, *Annals of the American Academy*, January, 1930, p. 100.

[25] U. S. v. Winslow (1913) 227 U. S. 202, 57 L. Ed. 481, 33 S. Ct. 253. See also U. S. v. United Shoe Machinery Co. (1918) 247 U. S. 32, 62 L. Ed. 968, 38 S. Ct. 473.

[26] See the article by Gilbert H. Montague, *Annals of the American Academy*, Jan. 1930, p. 179.

is especially true when enough rivals remain outside of the unification to insure competition. Two cases appear to bear out this assertion. In the first of these a suit was brought against the United States Steel Corporation. According to the evidence this corporation controlled somewhat more than half the output of steel in the United States. Yet the court found that the company was not guilty of a violation of the Sherman Law.[27] In another case, *United States v. International Harvester Company*, the government alleged that a consent decree of 1918 which the defendant company had entered into was inadequate to achieve its purpose and requested additional relief to restore competitive conditions. The court in refusing the request pointed out that while the International Harvester Company was much larger than any single competitor, it was but little larger than the aggregate of all competitors and that it apparently had not used its resources for the purposes or with the effect of restraining competition. The court stated that the law did not make mere size or the existence of unexerted power an offense when unaccompanied by unlawful conduct.[28]

The practices of a combination either in achieving or maintaining a dominant position are important factors to consider in trying to determine whether or not there has been a violation of the Sherman Act. The use of predatory, oppressive, or unfair practices are cogent evidence of the illegality of a combination. The tactics of the Standard Oil Company in securing railroad rebates, engaging in local price cutting, creating "bogus" independents, and dividing the United States into districts undoubtedly had much weight in convincing the court that the defendants had been guilty of a violation of the Sherman Act.[29]

Likewise, the tactics of the American Tobacco Company in driving competitors from the market unless they became parties to the combination, in expending vast sums of money to purchase rival plants which were immediately closed after the acquisition, or in making contracts with vendors forbidding them to compete with the purchaser during long periods of time

[27] U. S. v. U. S. Steel Corp. (1920) 251 U. S. 417, 64 L. Ed. 343, 40 S. Ct. 293.

[28] U. S. v. Int. Harvester Co. (1927) 274 U. S. 693, 71 L. Ed. 1302, 47 S. Ct. 748.

[29] Standard Oil Co. v. U. S. (1911) 221 U. S. 1, 55 L. Ed. 619, 31 S. Ct. 502.

had much to do with the decision of the Supreme Court that the company had violated the Sherman Antitrust Law.[30]

On the other hand, in the United States Steel Corporation case the Supreme Court found no such damaging evidence and therefore held that this company had not violated the Sherman Act. Competition had been vigorous but fair. The company had not secured freight rebates, had not increased its profits by lowering the quality of its products, had not engaged in local price cutting, had not endeavored to fix resale prices, and had not by any unfair means attempted to crush its competitors. The only practices which might have been construed as evidence of an illegal intent or material and direct restraint of trade were certain understandings pertaining to prices which the United States Steel Corporation had had at the time of the "Gary Dinners," and these had been discontinued long before the institution of the suit.[31]

The effect upon prices has been one of the most important factors to which the courts look to ascertain whether or not there has been a violation of the Sherman Act. The courts have condemned as a violation of the Sherman Act both *horizontal* and *vertical* price fixing. Many cases of the condemnation of *horizontal* price fixing can be found. In the Addyston Pipe and Steel Company case the Supreme Court found that the defendants had been successful in fixing and maintaining prices, thereby depriving the public of the benefits of competition.[32] In a decision which was rendered against the Trans-Missouri Freight Association, several railroads had entered into a contract by which they had agreed to fix and abide by rates in territory west of the Missouri River.[33]

In a suit against the Hardwood Manufacturers Association, certain lumber dealers had adopted an elaborate system of gathering and spreading reports concerning the industry. The court found that the prices of hardwood had been increased

[30] U. S. v. American Tobacco Co. (1911) 221 U. S. 106, 55 L. Ed. 663, 31 S. Ct. 632.

[31] U. S. v. U. S. Steel Corp. (1920) 251 U. S. 417, 64 L. Ed. 343, 40 S. Ct. 293.

[32] Addyston Pipe and Steel Co. v. U. S. (1899) 175 U. S. 211, 44 L. Ed. 136, 20 S. Ct. 96.

[33] U. S. v. Trans-Missouri Freight Ass'n (1897) 166 U. S. 290, 41 L. Ed. 1007, 17 S. Ct. 540.

during the period of time when this plan was in operation. Undoubtedly this finding had much to do with the decision that the defendants had violated the Sherman Antitrust Law.[34] On the other hand, the Supreme Court refused to hold that the compilation of data and its distribution among members of a trade association was a violation of the Sherman Law when there was no direct proof that such activity had adversely affected prices to consumers.[35] Likewise, the Supreme Court in 1933 upheld the validity of a selling agency known as Appalachian Coals Incorporated, which was organized to stabilize prices and production in the bituminous coal industry.[36]

The efforts of manufacturers and wholesalers to dictate resale prices furnish an illustration of *vertical* price fixing. However, the courts seemed unable to work out any consistent rules concerning agreements for resale price control. Sometimes they held that such agreements violated the Sherman Law and sometimes they held that they did not.[37] The situation with regard

[34] American Column and Lumber Co. v. U. S. (1921) 257 U. S. 377, 66 L. Ed. 284, 42 S. Ct. 114.

[35] Maple Flooring Ass'n v. U. S. (1925) 268 U. S. 563, 69 L. Ed. 1093, 45 S. Ct. 578.

[36] Appalachian Coals Inc. v. U. S. (1933) 288 U. S. 344, 77 L. Ed. 825, 53 S. Ct. 471.

[37] There appear to be four types of these agreements; those in which the buyer makes a *contract* with the seller that goods will be resold at a certain price; those in which the seller attaches a *condition* to the goods that they shall be resold at a certain price; those in which the seller makes an *agency agreement* with an agent who promises to handle the articles and to resell them at a certain price; and those in which the seller does not enter into any formal contract but has a *tacit understanding* that the goods must be resold at a fixed price.

The courts held that it was a violation of the Sherman Act to enter into an express contract that goods should be resold at a certain price. The restraint of trade consisted of forcing all dealers to sell at the same price, thus depriving the public of any advantage which might be derived from competition (*Dr. Miles Medical Co. v. Park and Sons Co.* (1911) 220 U. S. 373, 55 L. Ed. 502, 31 S. Ct. 376).

Likewise it was held to be a violation of the antitrust laws for a company to attach to an article of commerce a condition that the article should be resold at a certain price (*Straus v. Victor Talking Machine Co.* (1917) 243 U. S. 490, 61 L. Ed. 866, 37 S. Ct. 412).

On the other hand a contract of agency under which resale prices were fixed was not in violation of the antitrust laws according to a decision of the United States Supreme Court in the case of the *United States v. General*

to fixing resale prices has been changed by the laws of several of the states and by a Federal law known as the Miller-Tydings Act of 1937. About 40 states now have legislation on this subject. For example, the Illinois law provides that a vendor of commodities which bear the trade-mark, brand, or name of the producer may contract with the buyers for the maintenance of resale prices and that it is unfair competition where a person willfully offers such commodities at less than the stipulated price.[38] The Miller-Tydings Act, which is an amendment to the Sherman Act, provides in part as follows:

> . . . nothing . . . shall render illegal, contracts or agreements prescribing minimum prices for the resale of a commodity which bears . . . the trademark, brand, or name of the producer or distributor of such commodity . . . when contracts or agreements of that description are lawful as applied to intrastate transactions, under any statute . . . in effect in any State . . . and the making of such contracts or agreements shall not be an unfair method of competition under section 5 . . . of the act entitled "An Act to create a Federal Trade Commission. . . ."[39]

Electric Company. In this decision the manufacturers had agency contracts with merchants under which the manufacturers retained the title to the goods and dictated the resale prices. These agreements were valid despite the fact that they pertained to a large number of dealers, many of whom were general merchants and dealt in goods other than the goods of the manufacturers. Thus, by agency contracts a company could easily avoid a violation of the Sherman Law. Of course it was essential that such contracts be real agency agreements (*U. S. v. Gen. Elec. Co.* (1926) 272 U. S. 476, 71 L. Ed. 362, 47 S. Ct. 192).

The fourth type of case in which there was no formal agreement but merely a tacit understanding that goods must be resold at a certain price presented the most difficult situation. In the case of *United States v. Colgate Company* the Supreme Court decided that an understanding of this nature did not constitute a violation of the Sherman Act. The Colgate Company had urged dealers in its products to adhere to certain resale prices which it had fixed and announced that a failure to sell at the prescribed figure would result in a refusal upon the part of the Colgate Company to deal with the offending purchaser. According to the court, in the absence of any purpose to create or maintain a monopoly, the law did not restrict the long-recognized right of a trader or manufacturer to exercise freely his discretion in determining with whom he would deal (*U. S. v. Colgate and Co.* (1919) 250 U. S. 300, 63 L. Ed. 992, 39 S. Ct. 465).

[38] Revised Statutes of Illinois, 1937, Chap. 121½, Sec. 188. The constitutionality of this was upheld in Old Dearborn Distributing Co. v. Seagram Distillers Co. (1936) 299 U. S. 183, 81 L. Ed. 109, 57 S. Ct. 139.

[39] Public Act No. 314, 75th Congress, 1st Session, Title VIII, Sec. 1.

It appears that the question of whether the combination is beneficial or detrimental to the public is not one to which the courts ordinarily attach great weight. However, a few cases can be found in which the courts have placed some emphasis upon this factor.[40] One would suppose that under the "rule of reason" this would be an important consideration. Probably if the interpretation of the Sherman Act were entrusted to an administrative tribunal instead of the courts and the tribunal were reasonably free from court control, the benefit or detriment to the public of a particular combination might be a more important factor.

3. *Enforcement.*

The task of enforcing the provisions of the antitrust laws has always been difficult. One authority declared that to enforce the Sherman Law vigorously and vigilantly would be more difficult than the enforcement of "prohibition" laws and would shake the very foundations of our economic system.[41]

There are many reasons for the difficulties. In the first place, the size and financial strength of the units which are the objects of prosecutions is a great bar to adequate enforcement. Each important suit has involved a tremendous legal battle in which the government advocates have found themselves faced with some of the best legal talent in the country. Then there has always been the difficulty of discovering violations and securing the information which is necessary to prosecute successfully. As a rule, such information is peculiarly within the knowledge of the defendants and is often nearly inaccessible to the government.[42] Some of the more obvious combinations, such as holding companies or trusts, can be detected readily and enjoined, but scores of other subtle and clandestine combinations which are just as effective cannot be detected. Finally the very vagueness of the

[40] In the case of Maple Flooring Ass'n v. U. S. (1925) 268 U. S. 563, 69 L. Ed. 1093, 45 S. Ct. 578, the Supreme Court used language indicating that it was influenced in part in arriving at its decision by the social desirability of the combination which was being prosecuted.

[41] See *Annals of the American Academy*, January, 1930, p. 28.

[42] See "The Anti-trust Act and the Supreme Court," p. 71, in which Taft points out that much of the information concerning the purposes and conduct of a certain combination was made available to the court through the treachery of a stenographer.

Sherman Law and the contradictions in its interpretations undoubtedly tempt persons to try to circumvent its provisions and escape the consequences through the efforts of a group of clever lawyers.

No doubt there have been violations and illegal combinations contrary to the Sherman Act which have not been the object of enforcing authorities. Despite imperfections, however, the antitrust laws unquestionably have had a deterrent effect by preventing the existence of many injurious combinations and the use of many undesirable practices.[43]

Suits brought under the Sherman Antitrust Law are conducted entirely in the courts and are instituted by the attorney general or private litigants. Under the act several kinds of actions may be maintained. For one thing, it is possible to bring criminal prosecutions; and if the defendants are found guilty, they may be punished by a fine of $5,000, imprisonment for a term not to exceed a year, or both.[44] The criminal provisions have not been invoked with any marked degree of success. Some fines have been imposed, but there have been almost no imprisonments. One of the few successful criminal prosecutions brought under the Sherman Act was concluded a few years ago in a suit brought by the Federal government against candy "racketeers" in Chicago who were interfering with and restraining interstate commerce.[45] Furthermore, a person who has been injured by a violation of the Sherman Law may sue for damages in a Federal district court. Such person is entitled to threefold damages plus a reasonable attorney's fee.[46]

By far the most effective provisions, however, for enforcing the Sherman Act are those providing for injunctions. The district courts of the United States are invested with jurisdiction to prevent and restrain violations of the act by issuing injunctions at the request of the attorney general or private litigants.[47] Suits to enjoin violations have played an important part in the enforcement of the Sherman Law. By a judicious and elastic use of the injunction the Federal judiciary has been able to

[43] See "The Trust Problem" by Jenks and Clark, 4th ed., p. 282.

[44] U. S. Code, Title 15, Secs. 1 and 2.

[45] Boyle v. U. S. (1930) 40 Fed. 2d 49.

[46] U. S. Code, Title 15, Sec. 15.

[47] U. S. Code, Title 15, Secs. 4 and 26.

exercise a somewhat effective control over the activities of violators of the antitrust laws. In issuing their decrees the courts have tried to achieve the objects of the statute with the least possible disturbance to property rights or public interest.[48]

Judicial control of monopoly and restraint of trade under the Sherman Act has been the subject of much severe criticism. The problems which arise are essentially economic, yet the courts in dealing with them emphasize not the economic aspects but rather the legal. Moreover, the courts are incapable of dealing with the economic phases of these problems even if they are so inclined. Furthermore, the courts settle controversies but do not attempt to deal with problems before the stages of litigation have been reached. To meet this last objection the Department of Justice under the Coolidge administration tried a new plan under which proposed combinations or proposed practices of trade associations or corporations could be submitted in advance of their actual formation or adoption to the Department of Justice for suggestions.[49]

II. The Clayton Act.

The Sherman Law was decidedly vague as to the practices which constituted violations of its provisions. From the very beginning of its history certain persons believed that a more specific enumeration of prohibited practices would be desirable. In answer to these demands the Clayton Antitrust Law of 1914 was enacted. The act expressly prohibited certain practices when they tended to restrain competition or to create a monopoly.

Section 3 of the Clayton Act declared that it was unlawful to lease, sell, make a contract for the sale of commodities, fix a price, or give a rebate or discount on the condition, agreement, or understanding that the purchaser or lessee shall not deal in or use the goods of competitors when the effect would be to lessen competition substantially or tend to create a monopoly.[50]

[48] See the decree in American Tobacco Co. v. U. S. (1911) 221 U. S. 106, 55 L. Ed. 663, 31 S. Ct. 632.

[49] See the article by J. George Frederick, *Annals of the American Academy of Political and Social Science*, January, 1930, p. 101; also, Annual Report of the Attorney General, 1926, p. 33; also, Annual Report of the Attorney General, 1931, p. 21.

[50] U. S. Code, Title 15, Sec. 14.

Another provision of the Clayton Law, Section 2, forbade price discriminations by declaring that it was unlawful to discriminate in price between purchasers of the same kinds of commodities where the effect was to lessen competition substantially or tend to create a monopoly. Differences in prices were lawful where there was a difference in a grade, quality, quantity, or selling or transportation costs or where there was a difference which had been made in good faith to meet competition.[51] This provision has been amended by the Robinson-Patman Act of 1936, which is discussed in detail in the next chapter. The Clayton Act also forbids interlocking directorates and purchases of the stock of one corporation by another when the effect is unduly to restrain trade or to tend to create a monopoly.

The Clayton Act provides that suits for violations of its provisions may be instituted directly in the courts or may be handled through the Federal Trade Commission. The attorney general and private litigants may secure an injunction from a district court against persons who are found guilty of violating the act.[52] Also, the provision for recovery of threefold damages by injured persons applies to violations of the Clayton Act as well as to violations of the Sherman Act.[53] However, most of the suits instituted under the Clayton Act have been handled directly through the Federal Trade Commission.[54]

III. Acts Exempting Certain Organizations.

The Sherman Act was not only vague but it was also sweeping in its terminology condemning every restraint of trade and every attempt at monopolization. Recent years have witnessed a change in attitude. Many exceptions have been made not only by the courts under the "rule of reason" but also by Congress through statutory enactment.

The Webb-Pomerene Act of 1918 has exempted from the operation of the Sherman Act and Section 7 of the Clayton Act associations entered into for the purpose of and which are actually engaged in export trade. The Federal Trade Commis-

[51] U. S. Code, Title 15, Sec. 13.

[52] U. S. Code, Title 15, Secs. 25 and 26.

[53] U. S. Code, Title 15, Sec. 15.

[54] For a discussion of the work of the Federal Trade Commission in administering the provisions of the Clayton Act, see Chap. XVI.

sion has been given the power to approve and supervise such associations. By removing the restrictions of the antitrust laws, this act enables exporters to compete upon somewhat equal terms with foreign corporations.[55]

The Capper-Volstead Act of 1922 permits agricultural associations composed of groups of farmers, planters, ranchmen, dairymen, or nut and fruit growers to act together in preparing and handling goods for market or in marketing goods in foreign and interstate commerce. These associations must be operated for the mutual benefit of members, must not pay dividends in excess of 8 per cent, must not allow each member more than one vote, and must not deal in the products of nonmembers to an amount greater than the value of the products of members. The secretary of agriculture is given certain powers of supervision over these organizations. If he believes that they are monopolizing or restraining trade in foreign or interstate commerce to such an extent that the prices of products are being unduly enhanced, he may serve a complaint and hold a hearing. If the charges are found to be true, he may issue an order to cease and desist.[56] The reasons for making special exceptions of agricultural associations are obvious. The government is desirous of encouraging rather than discouraging cooperation among agricultural producers. One of the chief reasons for economic difficulties of the farmers is the lack of unified action. Instead of prohibiting monopoly the need is to remove all bars to cooperation.

The Clayton Antitrust Law of 1914 has made special exceptions for labor organizations.

As was previously mentioned, the Interstate Commerce Act has relieved carriers subject to its jurisdiction from the operation of the antitrust laws when they act in accordance with its provisions.

IV. State Statutes.

Most states have enacted antimonopoly statutes. Some of these were passed before the Sherman Antitrust Law of 1890, but most of them were enacted after that date. Some of the provisions of these statutes resemble the provisions of the Sherman Act. For example, one of the provisions of the statute of

[55] U. S. Code, Title 15, Secs. 61–65.
[56] U. S. Code, Title 7, Secs. 291–292.

Indiana against restraint of trade and monopoly states that every person who shall monopolize or attempt to monopolize any part of the trade or commerce within the state shall be deemed guilty of a misdemeanor and shall be liable to a fine of $5,000 or imprisonment for one year.[57] Some antimonopoly statutes are more specific than the Sherman Act. The states of Minnesota and South Dakota have laws forbidding agreements in restraint of trade which tend to control production or the price of any article of trade, manufacture, or use which is bought or sold within the state. The statutes of these states also forbid discrimination through the selling of commodities at a lower rate in one locality than in another where the intent is to destroy competition.[58]

State statutes have been used largely to strike at persons who are monopolizing or restraining business which is not interstate and foreign commerce.[59] However, state regulation of monopoly or restraint of trade has not played any very important part in the control of business. Most large businesses are engaged in interstate commerce and therefore come under the jurisdiction of the Federal government under the Sherman Act.

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[57] Burns' Indiana Statutes, annotated, 1933, Secs. 23–117.

[58] Mason's Minnesota Statutes, 1927, Secs. 10463–10464; Revised Code of South Dakota, 1919, Secs. 4353–4357 and 4365.

[59] See State v. Minneapolis Milk Co. (1913) 144 N. W. 417, 124 Minn. 34.

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CHAPTER XVI

THE CONTROL OF BUSINESS BY THE FEDERAL TRADE COMMISSION

The Sherman Antitrust law of 1890 declared that contracts, combinations, and conspiracies in restraint of trade were illegal. It did not, however, establish any special machinery but relied upon the attorney general's office, private litigants, and the courts for the enforcement of its provisions. Long before 1914 many persons, believing that these agencies were not effective, agitated for some sort of commission to aid in the enforcement of the Sherman Law. By 1914 there were many groups with diverse points of view on the question of proposed changes in the antitrust laws. Certain persons desired a continuance of judicial interpretation and regulation. This was the attitude of the late Chief Justice Taft, who felt that the courts were entirely competent to carry out the provisions of the Sherman Act.[1] Others desired a commission, probably hoping that such a body might be more tolerant than a militant attorney general's office and also hoping that it might be able to give information in advance on the legality of proposed combinations. Others believed that the law should be enforced more rigorously and desired an effective agency for achieving this object.[2] In 1914 the Federal Trade Commission was established and endowed with certain powers to prevent restraint of trade and unfair methods of competition.[3]

The work of the Federal Trade Commission can be divided roughly into four large categories: (1) conducting investigations, (2) preventing restraint of competition, (3) preventing unfair

[1] See "The Anti-trust Act and the Supreme Court" by William Howard Taft.

[2] See "Federal Trade Commission" by G. C. Henderson, p. 22.

[3] The debates in the Senate at the time the bill proposing a trade commission was under consideration throw some interesting light upon intentions of the framers of the Federal Trade Commission Act. See *Congressional Record*, 63rd Congress, 2d Session, Vol. 51, Parts X to XIII.

methods of competition, and (4) supervising export trade associations.

I. The Conduct of Investigations.

In 1903 the Department of Commerce and Labor was organized and the Bureau of Corporations was established as a subordinate division. This bureau was given the power to conduct investigations concerning the organization, conduct, and management of corporations engaged in interstate commerce.[4] A number of important investigations were undertaken and many corporations changed their organizations and their practices as a result.[5] With the establishment of the Federal Trade Commission, the Bureau of Corporations was abolished and its powers and duties were transferred to this newly-created body.

Under the Federal Trade Commission Act investigations may be conducted on the initiative of the commission, upon application of the attorney general, or upon the direction of the President or either house of Congress.[6]

In the course of its existence the commission has conducted numerous important investigations. It made a comprehensive survey of packers and stockyards. It conducted one inquiry into chain stores, another into the profits and competition in the petroleum industry, and another into stock dividends. In 1928, in response to a mandate of the Senate, the commission commenced an exhaustive investigation into the publicity methods and financial structures of utilities and brought to light a great deal of information concerning their propaganda and financial operations.[7] In ordering this investigation the Senate directed that the hearing should be public in order to bring it to the attention of the people.

Much has been done and much can be done through investigation. Certain industries may be engaging in practices which

[4] 32 Stat. L. 825.

[5] For a brief statement of some of the results of investigations made by the Bureau of Corporations, see "L'Oeuvre de la Federal Trade Commission" by Max J. Wasserman, p. 62.

[6] For a discussion of this, see "The Public Control of Business" by Keezer and May, Chap. IV.

[7] For the results of this investigation, see the monthly reports of the Federal Trade Commission to the Senate, Sen. Doc. 92, 70th Congress, 1st Session, Parts I–XIX.

are not actually illegal yet which are disapproved or condemned by the public. The commission by investigation and publicity may succeed in forcing companies to discontinue such undesirable practices. No organization cares to pursue even legal methods which are strongly condemned by the public. In addition, the work of investigation can be extremely valuable through the furnishing of expert information to Congress as to the necessity and content of proposed legislation.

II. The Prevention of Monopoly and Restraint of Trade.

Although the Federal Trade Commission under the Clayton Law and the Federal Trade Commission Act has been given considerable power to prevent monopoly and restraint of trade, its record of achievement has not been impressive. Again and again, it has struck at practices which it has believed to be in restraint of trade, only to discover that the Supreme Court or the Circuit Court of Appeals has disagreed with its findings and has reversed its decrees. The tendency of the courts has been to confine the commission's control of monopoly and restraint of trade within narrow limits and to construe very literally the pertinent statutory provisions.

It must be remembered that the Federal Trade Commission has not completely supplanted the attorney general's office in preventing monopoly and restraint of trade. Suits may still be brought directly in the courts under the Sherman Law and the Clayton Act and may be concluded without the intervention of the commission. Since 1914 many cases have been prosecuted in this way.[8] Furthermore, the commission is not given the power to prevent violations of the Sherman Law. The commission is given the authority, however, by the Clayton Act of 1914 to prohibit certain specific practices when they result in restraint of trade: namely, price discriminations, exclusive dealing agreements, stock ownership by corporations, and interlocking directorates.[9] In addition, the commission has been given the power to prevent *unfair methods of competition* under Section 5

[8] See for example, U. S. v. Colgate and Co. (1919) 250 U. S. 300, 63 L. Ed. 992, 39 S. Ct. 465. For a case prosecuted under the Clayton Act, see Van Camp and Sons Co. v. Am. Can. Co. (1929) 278 U. S. 245, 73 L. Ed. 311, 49 S. Ct. 112.

[9] U. S. Code, Title 15, Secs. 13, 14, 18, and 19.

of the Federal Trade Commission Act. The courts have declared that a practice which unduly restrains competition is unfair within the meaning of this section.[10]

The first of the practices mentioned above, namely, price discrimination, has been the subject of much investigation, legislation, and litigation. The Clayton Law of 1914 provided that it was unlawful to discriminate in price between different purchasers of the same kinds of commodities where the effect of such discrimination was to lessen competition substantially or to tend to create a monopoly.[11] Differences in price were permitted, however, where there was a difference in grade, quantity, or quality; where there was a difference in selling or transportation costs; or where a difference had been made in good faith to meet competition. This provision proved ineffective, however, to remedy the alleged abuses of price discrimination.

In the first place, the courts disagreed with the commission as to what constituted price discrimination and thus curbed attempts of the commission to deal with this practice. The commission believed that the practices of certain manufacturers of making different prices to purchasers of the same commodities violated this section of the Clayton Act. For example, a company which manufactured fishing equipment divided its customers into four categories, jobbers who were allowed a 50 per cent reduction from the list price, wholesalers who were allowed a 40 per cent reduction, retailers who were allowed a 33⅓ per cent reduction, and consumers who were allowed no reduction. These discounts applied regardless of the quantities purchased. The commission, believing that the defendants were violating the law, issued an order to cease and desist.[12] In another similar case, the commission issued an order to cease and desist against the Mennen Company, which was charging lower prices to persons whom it classified as wholesalers than it charged to others.[13] The Circuit Court of Appeals reversed this latter decision, declaring that what the Mennen Company had done

[10] See the Fed. Trade Com. v. Gratz (1920) 253 U. S. 421, 64 L. Ed. 993, 40 S. Ct. 572; Fed. Trade Com. v. Beech-Nut Packing Co. (1922) 257 U. S. 441, 66 L. Ed. 307, 42 S. Ct. 150.

[11] U. S. Code, Title 15, Sec. 13.

[12] Fed. Trade Com. v. South Bend Bait Co. (1922) 4 F. T. C. D. 355.

[13] Fed. Trade Com. v. Mennen Co. (1922) 4 F. T. C. D. 258.

was merely to give wholesalers a discount which was not allowed to retailers and that such action did not indicate any purpose to create or to maintain a monopoly.[14] In another case the Federal Trade Commission issued orders against certain manufacturers who were giving a graduated discount to owners of chain stores and refusing to allow owners of single stores to pool their purchases for the purpose of computing a discount. Again the Circuit Court of Appeals reversed the commission and held that the defendants had not violated this section of the Clayton Act.[15] These decisions of the Circuit Court of Appeals struck at the roots of the commission's power to prevent price discriminations. If such practices did not fall within the prohibitions of Section 2 of the Clayton Law, few cases could be brought thereunder.[16] To a great extent the differences between the courts and the commission could be attributed to the vague phraseology of this section, which forbade only those price discriminations which tended to create a monopoly or to lessen competition substantially.[17] Obviously, such indefinite words offered great opportunity for differences of opinion.

In the second place this provision of the Clayton Act was not broad enough in its terminology to cover many methods of discrimination between customers which were quite as injurious as outright price discriminations. It was found, for example, that certain chain stores were receiving from manufacturers secret rebates, discounts, and advertising allowances.[18] As a result of an investigation of this situation Congress in 1936 enacted the Robinson-Patman Act, which amended Section 2 of the Clayton Act by enlarging the authority of the Federal Trade Commission

[14] Mennen Co. v. Fed. Trade Com. (1923) 288 Fed. 774.

[15] National Biscuit Co. v. Fed. Trade Com. (1924) 299 Fed. 733.

[16] For a case in which the Supreme Court held that price discrimination was illegal, see Van Camp and Sons v. Am. Can Co. (1929) 278 U. S. 245, 73 L. Ed. 311, 49 S. Ct. 112.

[17] See "L'Oeuvre de la Federal Trade Commission" by Max J. Wasserman, p. 196, where the author sums up this section of the Clayton Law as follows: "Ce texte, malheureusement, est si peu clair et ses prescriptions sont limiteés par de si larges exceptions, qu'il n'a pas fourni à la Commission des armes très efficaces pour intervenir en matière d'escomptes commerciaux."

[18] See the statement of Representative Wright Patman in the House of Representatives, reported in *Congressional Record*, Vol. 79, p. 12528, 74th Congress, 1st Session.

to prevent price discrimination. It is still unlawful to discriminate in price between different purchasers of commodities of like grade and quality.

The Robinson-Patman Act provides also that it is unlawful to pay either to a purchaser or his agent any commission, brokerage, allowance, or discount except for services rendered; that it is unlawful to furnish facilities to customers unless they are open to all on equal terms; or that it is unlawful to furnish services or to pay customers for services connected with processing or handling of goods unless such allowances are offered to all persons on equal terms. Under the Robinson-Patman Act it is unlawful not only for the *seller* to *give* a discrimination but it is unlawful also for the *purchaser* to *receive* a discrimination in price. It is also unlawful for *any person* to be a party to, or to assist in, a discrimination.

One of the most interesting provisions of the Robinson-Patman Act states that when a prima facie case of discrimination has been established the burden of rebutting this presumption rests on the defendant. Any person found guilty of violating the provisions of the Robinson-Patman Act may be fined $5,000 or sentenced to not more than one year in jail, or both.[19] The Federal Trade Commission has already charged several companies with violations of the provisions of the Robinson-Patman Act.[20]

Another section of the Clayton Law makes it unlawful to sell, lease, contract for the sale of goods, fix a price, or give a rebate or discount on the condition, agreement, or understanding that the lessee or purchaser shall not use or deal in the goods of a competitor where the effect is to lessen competition substantially or tend to create a monopoly.[21]

The Federal Trade Commission believed that two practices, the making of *tying contracts* and the making of *exclusive dealing agreements*, violated this section of the Clayton Act. In a *tying contract* a company sells or leases certain of its products but only in conjunction with other products which it has to sell or to lease. In an *exclusive dealing agreement* a seller or lessor requires the purchaser or lessee to agree not to deal in the goods of another. Due to the attitude of the Federal courts the

[19] Public Act No. 692, 74th Congress, 2d Session, approved June 19, 1936.
[20] Annual Report of the Federal Trade Commission, 1937, p. 48.
[21] U. S. Code, Title 15, Sec. 14.

commission has had little success in eradicating either of these practices.

In trying to prevent *tying contracts* the commission prosecuted certain oil companies for agreements which it felt violated the above provision of the Clayton Law and which it believed constituted unfair methods of competition in violation of the Federal Trade Commission Act. These oil companies had leased pumps and tanks bearing their names and had made agreements that such equipment should be used only with gasoline supplied by the lessor. The commission issued orders to cease and desist, but the court reversed the orders, alleging that the contracts did not violate the Clayton Law since they were not agreements *not to deal in the goods of another.*[22]

Two cases will illustrate the reasons for the failure of the Federal Trade Commission in its efforts to prevent *exclusive dealing* arrangements. In the first of these cases the Curtis Publishing Company made certain agreements with its agents not to sell or distribute the magazines or newspapers of other publishers. The commission decided that these agreements violated Section 3 of the Clayton Law and ordered the Curtis Publishing Company to cease and desist. The Supreme Court of the United States, however, disagreed with the commission and held that the agreements in question were contracts of *agency* and that such contracts did not fall within the prohibitions of the Clayton Act.[23] This decision of the Supreme Court has provided a splendid loophole for companies desirous of evading the Clayton Act. By making agency contracts, and this is not at all difficult, companies can easily achieve their purposes without violating the law. If a company cannot circumvent this section of the Clayton Act through the use of an agency agreement, it may be able to escape by proving that its exclusive dealing agreement does not tend to create a monopoly or restrain competition. For example, the commission issued an order to cease and desist against a company which had entered into exclusive dealing contracts with its customers, but the order was set aside because the company controlled so small a percentage of the oleomargarine

[22] Fed. Trade Com. v. Sinclair Refining Co. (1923) 261 U. S. 463, 67 L. Ed. 746, 43 S. Ct. 450.

[23] Fed. Trade Com. v. Curtis Publishing Co. (1923) 260 U. S. 568, 67 L. Ed. 408, 43 S. Ct. 210.

trade that the court did not believe that the contracts were in restraint of competition or tended to create a monopoly.[24]

Another practice which is specifically forbidden by the Clayton Act is the acquisition by one company of stock in a competing company.[25] This prohibition, however, is not absolute but is subject to a number of qualifications. In the first place, the effect of such acquisition must be to lessen competition substantially, to restrain trade, or to tend to create a monopoly. Furthermore, this section does not apply to corporations purchasing stock solely for investment purposes where they are not using the stock by voting or otherwise to bring about the substantial lessening of competition. Finally, the act provides that there is nothing in this section to prevent corporations from causing the formation of subsidiary corporations for the carrying on of their lawful business or the natural or legitimate branches of such business or holding stock in such subsidiaries where the effect is not to lessen competition substantially.

The power of the Federal Trade Commission to prevent violations of this section has been considerably curtailed by a decision of the United States Supreme Court. Certain companies had acquired the physical assets and capital stock of competitors. The commission ordered the companies to divest themselves of the physical assets and the capital stock. The Supreme Court set the order aside, alleging that the commission had no power to order a dispossession of physical assets even though these had been obtained as the result of an illegal acquisition of stock where the acquisition of physical assets had been consumated before the commission filed its complaint.[26] Although the decision is perhaps technically correct under the pertinent sections of the Clayton Act, it has placed a premium upon rapidity of action. If the corporation can move quickly enough, a situation can be created which is beyond the power of the commission to correct.[27]

Another practice which is prohibited under the Clayton Act is that of maintaining *interlocking directorates*. The act forbids

[24] Pearsall Butter Co. v. Fed. Trade Com. (1923) 292 Fed. 720.

[25] U. S. Code, Title 15, Sec. 18.

[26] Fed. Trade Com. v. Western Meat Co. (1926) 272 U. S. 554, 71 L. Ed. 405, 47 S. Ct. 175.

[27] For a discussion of this decision and the difficulties which it placed in the way of the commission, see the Annual Report of the Federal Trade Commission, 1929, p. 59.

the same persons to act as directors in two or more corporations. The prohibition is not absolute but applies only to corporations engaged in commerce with capital, surplus, and undivided profits aggregating more than $1,000,000. Furthermore, the section applies only when such corporations are competitors.[28]

As has been previously stated, the Federal Trade Commission has been given the power to prevent unfair methods of competition under Section 5 of the Federal Trade Commission Act and the courts have declared that a practice which unduly restrains competition is unfair. As a result, in addition to the authority which it derives from the Clayton Act, the commission has general authority to prevent monopoly and restraint of trade. The power thus conferred upon the commission is as broad as that conferred upon the courts and the attorney general under the Sherman Act.

III. The Prevention of Unfair Methods of Competition.

Section 5 of the Federal Trade Commission Act contains this statement:

> Unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.[29]

This is followed by a provision which empowers the commission to prevent such methods.

A tremendous battle was waged in the Senate over this section of the act. Many persons who supported the creation of the commission and who approved the provisions which gave the commission the power to prevent restraint of competition opposed the section which gave the commission the power to prevent unfair methods of competition. In the first place, they objected to this section because of its alleged inconsistency with the Sherman Law. They argued that the Sherman Law ordered corporations to compete; whereas the proposed section would severely curb and check methods of competition. Those who favored Section 5 answered that in business there was fair and unfair competition just as in warfare there was civilized and barbarous warfare.

[28] U. S. Code, Title 15, Sec. 19.

[29] U. S. Code, Title 15, Sec. 45 as amended by Public Act No. 447, 75th Congress, 3d Session, approved March 21, 1938.

Opponents attacked Section 5 also on the ground that it was too vague and indefinite and that the term "unfair methods of competition," was incapable of exact definition because there was no general agreement as to which practices were fair and which were unfair. Those who favored this section pointed out that an attempt to cover the field by an enumeration of all practices would be folly, for no sooner would twenty practices be prohibited than twenty more equally vicious would make their appearance. The commission would be powerless to prevent these unenumerated practices. Furthermore, advocates of Section 5 argued that the term, "unfair methods of competition," was just as definite and could be just as effectively enforced as the term, "reasonable rate," or the term, "unjust discrimination." The adoption of a general provision rather than a specific one would have the obvious advantage of being adjustable to new practices and conditions as they arose.[30]

Although the commission has been granted broad powers under Section 5, it does not have general jurisdiction to invade the field of private business in order to improve business ethics and conduct. In fact, its jurisdiction with regard to unfair methods of competition has very definite limits. In the first place, its power does not extend to all commerce but only to commerce among the several states, with foreign nations, with the territories, and in the District of Columbia. When the commission attempts to control companies which are not engaged in interstate or foreign commerce, it acts beyond its authority, as can be seen from the following case. A certain baking company sent its drivers across the state line to sell and deliver bread. The drivers were giving to each customer free of charge a quantity of bread equal to the amount which the customer had purchased. The commission held that this free distribution of bread was an unfair method of competition and ordered the offenders to cease and desist. The court, however, reversed the decision on the ground that this selling and delivering of bread was not interstate but was intrastate commerce and hence was not subject to the control of the Federal Trade Commission. It was true that in carrying the bread from one state to another the drivers were moving in interstate commerce, but the trans-

[30] See the debate in the Senate on this Section, *Congressional Record*, 63rd Congress, 2d Session, Vol. 51, Parts X–XV.

actions which the commission endeavored to prohibit, the giving of bread with the selling of bread, were intrastate commerce and therefore beyond the jurisdiction of that body.[31]

In the second place, in order to give the commission jurisdiction there must be some *public interest* in preventing the practice alleged to be unfair. The exact meaning of this somewhat nebulous term, *public interest*, is by no means easy to discover. The Supreme Court has declared that in order to justify the filing of a complaint the public interest must be specific and substantial and not merely the slight community interest in the maintenance of private rights. Justice Brandeis has pointed out that sometimes interference is justified in the public interest because a particular method threatens the existence of competition; sometimes interference is justified because there is a flagrant oppression of the weak by the strong; and sometimes because a great loss which is resulting from the practice is a matter of serious consequence to the public but being small for each individual it probably will not be the subject of a private suit.[32]

In the third place, the practice which the commission is seeking to stamp out must be an *unfair method of competition or a deceptive act or practice in commerce.* The phrase "unfair method of competition or deceptive act or practice in commerce" is so broad and indefinite that it is extremely difficult to formulate any adequate or precise definition. For one thing, the term seems to include more than practices which tend toward monopoly or restraint of competition. At least, this was the point of view of Senator Cummins, who was one of the framers of the act. At the time the bill was under consideration, he remarked:

> There may be unfair competition which does not constitute restraint of trade. Unfair competition must usually proceed to great lengths and be destructive of competition before it can be seized and denounced by the antitrust law.[33]

The Supreme Court of the United States has also recognized this distinction. In enumerating practices which violate Section

[31] Ward Baking Co. v. Fed. Trade Com. (1920) 264 Fed. 330.

[32] Fed. Trade Com. v. Klesner (1929) 280 U. S. 19, 74 L. Ed. 138, 50 S. Ct. 1.

[33] *Congressional Record*, 63rd Congress, 2d Session, Vol. 51, p. 11455.

5 of the Federal Trade Commission Law the court has listed among others those practices which unduly hinder competition.[34]

For another thing the term "unfair methods of competition" refers to practices which contain some element of deception, fraud, or oppression. According to the Supreme Court:

> The words, "unfair method of competition" . . . are clearly inapplicable to practices never heretofore regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or to create a monopoly.[35]

In other words, it appears that not all practices which give one company an advantage over its rivals are unfair within the meaning of this section. Two cases illustrate this. In the first of these cases the practice of leasing oil pumps and requiring the use of the lessor's oil in selling from these pumps was held not to be an unfair method of competition.[36] Likewise the practice of refusing to sell steel bands except in connection with jute bags was held not to constitute a violation of Section 5.[37]

Inasmuch as the terms unfair methods of competition or deceptive acts or practices cannot be precisely defined, their meaning can be determined better by looking at the specific practices which have been condemned by the Federal Trade Commission and the courts. In other words, by a process of inclusion and exclusion it may be possible to arrive at a better understanding of the terms. The Federal Trade Commission has published a long list of practices which it regards as unfair and which it condemns.[38] Most of these practices can be classified under one of the following headings: misbranding, passing off, commercial bribery, price cutting, and commercial espionage.[39]

[34] This is the point of view of Milton Handler in an article in 31 *Columbia Law Review* 527–560.

[35] Fed. Trade Com. v. Gratz (1920) 253 U. S. 421, 64 L. Ed. 993, 40 S. Ct. 572.

[36] Fed. Trade Com. v. Sinclair Refining Co. (1923) 261 U. S. 463, 67 L. Ed. 746, 43 S. Ct. 450.

[37] Fed. Trade Com. v. Gratz (1920) 253 U. S. 421, 64 L. Ed. 993, 40 S. Ct. 572.

[38] See the Annual Report of the Fedreal Trade Commission, 1929, p. 88.

[39] For a discussion of certain unfair methods of competition, see "Unfair Competition" by William H. S. Stevens.

One of the most common practices which the Federal Trade Commission has endeavored to prevent is *misbranding*. This practice has been very widespread and has assumed a great variety of forms. One of its most prevalent forms has been misrepresentation of the quality of goods which are being offered for sale. Time and again the commission has condemned and has endeavored to stamp out this practice. For example, a certain company represented its products as all wool; whereas in reality the goods contained but 20 to 80 per cent wool. According to the commission such representations constituted a violation of the law. The commission declared that the practice was unfair to honest manufacturers and competitors and could not be condoned merely because it had been common in the trade.[40] In another similar case a baking-powder company made a choice product which contained no alum. Later the composition of the product was changed, the price was lowered, but almost the same label was used. The commission found that this was unfair as it led the public to believe that the quality had not changed.[41]

Many other cases of misbranding have been brought to the attention of the commission and have been condemned. For instance, in order to take advantage of the enviable reputation which Swedish matches had acquired, certain companies printed Swedish words on the boxes although the matches were actually made in Japan.[42] Companies engaged in renovating and rebuilding typewriters sometimes represented their products as new. Other companies represented that their goods and supplies were made under specifications for the government or were surplus government stock; whereas in reality this was not the situation. Some companies marked their prices up, then down, and then represented to the purchasers that the goods were being offered at tremendous sacrifices.[43]

[40] Fed. Trade Com. v. Winstead Hosiery Co. (1922) 258 U. S. 483, 66 L. Ed. 729, 42 S. Ct. 384.

[41] Fed. Trade Com. v. Royal Baking Powder Co. (1921) 4 F. T. C. D. 1; affirmed in 281 Fed. 744.

[42] Fed. Trade Com. v. Taiyo Trading Co. (1919) 3 F. T. C. D. 199.

[43] For a discussion of misbranding, see "The Federal Trade Commission" by G. C. Henderson, Chap. IV. See also "L'Oeuvre de la Federal Trade Commission" by Max J. Wasserman, Chap. IV, Sec. I.

Another very prevalent practice has been that of *passing off* goods as the goods of a rival firm with an enviable reputation. Sometimes a company has imitated the appearance of the products of another manufacturer by placing its goods in similar packages, sometimes it has used a trade-mark very much like that of a rival corporation, and sometimes it has attempted to operate under a name very closely resembling that of a well-known firm.

In several cases the commission has issued orders to cease and desist against persons who were attempting to pass off their goods as those of another in violation of the trade-mark laws. For example, it ordered one corporation to refrain from using the name, Racine Tire Sales Company, because it found that this use infringed the registered trade-mark of a rubber company.[44] In another case, a certain milliner in the District of Columbia was ordered to cease and desist from doing business under the name of Louise because the labels which she used in advertisements were very much like those of a well-known and long-established firm selling the same merchandise under the name of Marie Louise.[45]

Far more commonly, the commission has intervened to prevent fraud and deception which has not involved the violation of a registered trade-mark. Two enterprising taxicab drivers in the District of Columbia had themselves listed several times in the telephone directory under names similar to those of well-known taxicab companies. Thus, when they desired to make use of the name of the Yellow Cab Company they adopted the names Yellow Bell Taxi Company and Yellow Ford Taxi Company. In this way their assumed names appeared in the telephone directory immediately before and immediately after that of the Yellow Cab Company. The commission found that these practices were unfair and issued an appropriate order.[46] In another case, a certain company made and sold a well-known salve under the trade-name, "mentholatum." Another company began to manufacture a similar preparation, dressed it in similar packages, and adopted for its trade-name the word,

[44] Fed. Trade Com. v. Racine Tire Sales Co. (1922) 5 F. T. C. D. 327.
[45] Fed. Trade Com. v. Louise (1922) 4 F. T. C. D. 323.
[46] Fed. Trade Com. v. Maltby (1923) 5 F. T. C. D. 473.

"mentholanum." The Federal Trade Commission decided that this constituted an unfair method of competition.[47]

The practice known as *commercial bribery* has caused the commission much concern. It consists of paying employees of customers in order to induce them to purchase or to persuade their employers to purchase goods. This practice was particularly widespread and vicious in the selling of supplies to ships. Owners were accustomed to leave the purchasing of most commodities to officers in charge of the ships. It had become quite common for many companies selling supplies to give such officers 5 per cent or even 10 per cent commission on their purchases. The commission struck at this practice and held that it was a violation of Section 5 of the Federal Trade Commission Law.[48] The commission tried to go even farther and endeavored to prohibit companies from giving presents, such as candy, cigars, meals, and theater tickets to employees of prospective customers and issued orders to cease and desist.[49] The Circuit Court of Appeals, however, reversed the order of the commission in one of these cases and held that such donations were not matters so affecting the public as to be within the jurisdiction of the Federal Trade Commission.[50] The court appeared to think that while the practice might be unfair to rival corporations there was not sufficient *public interest* to warrant interference on the part of the commission.

Under certain circumstances *price cutting* has been regarded as an unfair method of competition. The leading case is that of the *Federal Trade Commission v. Sears Roebuck Company.* This company, realizing that all persons would know the price of sugar, offered at less than cost a limited amount of sugar to customers who purchased a certain number of other commodities. The company represented to customers that the low price of sugar was the result of the saving which the company could make by purchasing in large quantities. The commission decided that this was a violation of Section 5 of the Federal Trade Com-

[47] Fed. Trade Com. v. Black and Co. (1918) 1 F. T. C. D. 154.

[48] For a list of the cases on this point, see "The Federal Trade Commission" by Henderson, p. 217. In the Annual Report of the Federal Trade Commission, 1929, p. 88, this practice is listed as an unfair method of competition.

[49] Fed. Trade Com. v. Fleischman Yeast Co. (1918) 1 F. T. C. D. 119.

[50] New Jersey Asbestos Co. v. Fed. Trade Com. (1920) 264 Fed. 509.

mission Law.[51] The unfairness in this case lay not so much in the selling of sugar below cost as in the misrepresentation to the public. The commission has listed, however, as an unfair method of competition the giving or selling of goods at less than cost in large quantities so as to hamper and embarrass small competitors.[52]

The practice of *commercial espionage* consists of using spies or detectives to discover the volume of business, the names of customers, and other trade secrets of a competitor. Sometimes companies desiring this information have hired employees of a competitor for this purpose; sometimes they have employed railroad, telephone, or telegraph operators to furnish the information. The Federal Trade Commission has listed commercial espionage as an unfair method of competition.[53]

A recent amendment to the Federal Trade Commission Act has provided that false and misleading advertising of foods, drugs, devices, or cosmetics is an unfair or deceptive practice within the meaning of Section 5 of the Federal Trade Commission Act.[54]

The procedure of the Federal Trade Commission in preventing unfair methods of competition is an interesting study in administrative procedure, presenting some distinctive contrasts with procedure through the courts. A case may originate by the application for a complaint or by the direction of the commission. The rules of the commission permit any person, partnership, corporation, or association to make application for the issuance of a complaint.[55] No formality is required in making the application except that it must be made in writing, must be signed by the applicant, and it must contain a short and simple statement of the facts. An ordinary letter will suffice if it meets these requirements. It is the substance alone which counts and not the technical rules of procedure, as is too frequently the situation in the courts.

[51] Fed. Trade Com. v. Sears Roebuck and Co. (1918) 1 F. T. C. D. 163; upheld in 258 Fed. 307 (1919).

[52] See the Annual Report of the Federal Trade Commission, 1929, p. 89.

[53] See the Annual Report of the Federal Trade Commission, 1929, p. 88. For a discussion of this practice, see "Unfair Competition" by W. H. S. Stevens, p. 154.

[54] Public Act No. 447, 75th Congress, 3d Session; Approved Mar. 21, 1938.

[55] See "Rules of Practice of the Federal Trade Commission," Rule IV.

Upon receipt of the application certain jurisdictional questions are considered: namely, whether or not the alleged unfair practice is being carried on in interstate commerce, whether or not a complaint will be in the public interest, and whether or not there is an unfair method of competition. If the essential jurisdictional elements are present the application is docketed as a formal "application for the issuance of a complaint."

The next step in the proceedings is to assign the matter to an examining attorney, who obtains the facts from the party making the complaint and the party complained against. When this investigation has been completed the evidence is summarized and a recommendation is made to the commission as to the action which should be taken on the complaint. There are three possible courses of action which may be recommended to the commission: dismissing the complaint, entering into a stipulation, or issuing a complaint. Thus far the proceedings have not been made public, and the names of the parties have been kept secret. Furthermore, no complaint has been issued.

The commission next scans the entire record and after careful consideration decides which of the three above-mentioned courses of action should be pursued. If the commission decides that the case should be dismissed, the proceedings are dropped and no complaint is issued. If the commission decides that a complaint should be made, it is issued in the name of the commission. This latter fact affords an interesting illustration of the nature of these proceedings and the character of the commission. The contest is not a contest between private litigants but is a proceeding between the representatives of the public and an alleged violator of the law. The supposed wrongdoer has not only committed an offense against the party making the complaint but has also injured the public. It is fitting, therefore, that a governmental agent should be one of the parties to the suit. The person who originally launched the complaint disappears, and a governmental agent takes his place. After its issuance the complaint is served according to the rules set forth by the commission, and an opportunity is given for the defendant to file an answer. A failure to make an answer within the time specified constitutes an admission of all the allegations contained in the complaint and authorizes the commission to find that they are true and to dispense with a hearing on the charges.

In a contested case, hearings are usually held before a trial examiner. Such hearings are held in various places throughout the United States. When the taking of testimony has been completed and all evidence submitted, the trial examiner prepares a report of the facts. Finally, the case comes before the commission for final argument and consideration. If the complaint is sustained, the commission makes its findings of fact and conclusion of law and issues an order to cease and desist. If, on the other hand, the commission finds that the complaint should not be sustained, an order of dismissal is entered.[56]

Insofar as procedure before the commission is concerned, the order to cease and desist brings the matter to a conclusion. An order to cease and desist becomes final 60 days after its issuance unless a petition is filed for a review of the order. A defendant may apply to a Circuit Court of Appeals for a review of the commission's decision. Violation of the order to cease and desist after it has become final subjects the offender to a civil penalty of $5,000 recoverable by the United States.[57]

A slight variation in the regular procedure is presented when the commission proposes that a stipulation should be entered into. In a stipulation the party accused of violating the Federal Trade Commission Act promises to discontinue the offending practice. The making of a stipulation has certain decided advantages for the defendant. Although the facts are made public so that the method of competition which is condemned may be known, the name of the party is not revealed. This enables an offender to escape the undesirable notoriety which often accompanies a hearing and a trial. Such stipulations are usually allowed by the commission unless the practice is so fraudulent or so vicious that the protection of the public demands the use of the regular procedure by complaint.[58]

The holding of *trade practice conferences* for the purpose of outlawing unfair methods of competition presents an entirely different method of procedure. At first it was not extensively

[56] For a good brief description of the procedure of the commission, see the Annual Report of the Federal Trade Commission, 1934, p. 45.

[57] U. S. Code, Title 15, Sec. 45, as amended by Public Act No. 447, 75th Congress, 3d Session, approved Mar. 21, 1938.

[58] Over 100 stipulations were approved and accepted during the year ending June, 1929. For a list, see Annual Report of the Federal Trade Commission, 1929, p. 217.

used by the commission. Subsequently its popularity necessitated the creation of a Trade Practice Conference Division. The report of the commission for 1929 listed 31 such conferences held during the previous year, covering industries which are as diverse as beauty and barber supply dealers and barn equipment companies.[59] In holding trade practice conferences the commission is encouraging self-regulation of industry. Through this type of procedure an opportunity is afforded to an industry to purge itself on its own initiative of unfair methods of competition. While the commission has aided and encouraged commercial and industrial groups desirous of drawing up rules for their own regulation, it has left the initiative mostly to the representatives of these groups.

A trade practice conference is usually called upon the application of a representative body in the industry. Before calling a conference the commission must have an expression of desire from a substantial majority of the members of an industry. The commission then authorizes a conference, fixes a time and place for meeting, and appoints a representative to preside. Anyone engaged in the industry may participate. Resolutions are introduced, discussed, amended, and adopted. The rules adopted are transmitted to the commission for approval. In turn, the commission sends those which are approved to the various members of the industry. Each member is asked to sign a statement indicating that he intends to comply with the rules. The rules approved by the commission are designated as Group I and Group II. Those which fall under Group I are considered to be unfair methods of competition within the prohibitions of Section 5 of the Federal Trade Commission Act, and appropriate proceedings will be taken by the Commission for violation of these. Those which fall under Group II are not in themselves violations of the law. They are merely practices which the industry considers unethical, uneconomical, or in some way objectionable. The observance of such rules must depend upon the cooperation of the members of the industry concerned.[60]

The trade practice conference procedure has advantages over the regular procedure of the Federal Trade Commission. In the

[59] See the Annual Report of the Federal Trade Commission, 1929, p. 34.

[60] See the Annual Report of the Federal Trade Commission, 1936, p. 99.

first place, it is to a great extent self-regulation. The calling of the conference takes place on the initiative of the industry, the rules are proposed and adopted by the industry, and their enforcement depends to some extent upon the cooperation of those engaged in the industry. In the second place, a trade practice conference usually outlaws a number of practices. As a rule, the regular commission procedure strikes at only one or two. In the third place, trade practice conference rules cover a large group of persons. The orders to cease and desist which the commission issues in its regular procedure are directed at isolated individuals or corporations. To strike at a few persons while scores of others are doing the same thing is almost a futile gesture.

IV. The Supervision of Export Trade Associations.

The Webb-Pomerene Act of 1918 offers exemption from the antitrust laws to associations organized for the sole purpose of engaging in export trade. One of the primary purposes of the act is to enable exporters to compete in foreign markets on an equal footing with corporations of other countries. The Federal Trade Commission is given the task of supervising associations which operate according to the provisions of the Webb-Pomerene Act. Export trade associations are required to file with the commission copies of their organization papers and to furnish information to the commission when called upon as to their organization, conduct, or management. If the commission believes that an association is violating the law, it may investigate and make recommendations for adjustment. If a recommendation is not complied with, the findings of the commission may be referred to the attorney general for appropriate orders.[61] No formal complaints or orders have been issued under the act nor have the courts been called upon to construe or interpret the law.[62]

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[61] For additional information on the Webb-Pomerene Act, see Chap. XV.

[62] See Annual Report of the Federal Trade Commission, 1937, p. 109.

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CHAPTER XVII

FEDERAL CONTROL OF PACKERS, STOCKYARDS, AND COMMODITY FUTURES

I. Regulation of Packers and Stockyards.

For some time prior to 1920 there had been agitation against the group of packers commonly known as the "big five," Swift, Armour, Morris, Cudahy, and Wilson. It was charged that the "big five" had secured a virtual monopoly of the packing business and had been guilty of certain unfair and discriminatory practices in the operation of stockyards and other facilities which were under their control. The agitation led to important investigations by the Federal Trade Commission and the Senate Committee on Agriculture. These investigations revealed substantial grounds for many of the charges and brought to light practices which were detrimental to consumers, to competitors, and to producers of livestock.

It was found, for instance, that the "big five" had acquired considerable control over businesses allied to the packing industry. They owned or dominated stockyard facilities, railroad switching facilities which they used in connection with their plants, refrigerator car companies, and cold storage plants. They were manufacturing and dealing in by-products, such as wool, hides, and fertilizers. They were spreading their control over numerous meat substitutes, such as fish, poultry, and eggs, over dairy products, and over vegetable-oil preparations. They had gone into the business of canning fruits and vegetables. They had commenced to deal in various staple groceries, such as rice, sugar, potatoes, beans, and coffee. In handling these products the packers had a decided advantage over competitors because they could employ their immense selling organizations which had been built up in connection with the packing industry.[1]

[1] Report of the Federal Trade Commission on the Meat Packing Industry, 1919. See also Hearings before the Committee on Agriculture and Forestry of the United States Senate, 66th Congress, 1st Session, 1919.

Inasmuch as the "big five" bought most of the livestock at the large markets throughout the United States, it was possible for them by concerted action to control the general price level from day to day. Through a centralized control they could and did determine even before the markets opened the prices to be paid for stock. Many interesting illustrations of this were brought out in the report of the Federal Trade Commission. The procedure of "wiring on," as it was called, afforded one means of control. If a shipper or a producer were dissatisfied with the prices offered at the first market to which he had shipped his livestock and decided to try another, he often found that he could get no better price at the second market. The big packers had telegraphed over their private wires, notifying their buyers at the second market of the prices which had been offered at the first market.[2] Another method used to control the market was known as "part purchases." In this scheme the large packers joined and purchased together all of the livestock of one shipper.[3] A third method, "split shipment purchases," was employed when a shipper decided to divide his stock between two markets. In such an event the big packers kept a record and caused the split lots to sell at the same price on the different markets.[4]

In its investigation of the handling of livestock, the Federal Trade Commission found many complaints from shippers. There were objections to the frequent delays in the switching and unloading of animals. It was alleged that there were not sufficient scales to handle the weighing of livestock so as to prevent unnecessary delays. Such delays resulted in weight shrinkage which usually meant a financial loss to the shipper and a gain to the buyer. There were many complaints, also, that feeding charges were too high.[5] Furthermore, the commission

[2] Report of the Federal Trade Commission on the Meat Packing Industry, 1919, Part II, p. 89.

[3] Report of the Federal Trade Commission on the Meat Packing Industry, 1919, Part II, p. 78.

[4] Report of the Federal Trade Commission on the Meat Packing Industry, 1919, Part II, p. 84.

[5] Report of the Federal Trade Commission on the Meat Packing Industry, 1919, Part III, p. 87. In this connection the statement of William Atkinson, a livestock producer, is interesting. He said, "From the time that my cattle arrive at the yards they are in the hands of the man that is eventually going to buy them for slaughter. We often have to wait anywhere from two hours

men, who were supposedly independent intermediaries between livestock growers and packers, were in reality merely agents of the packers from whom they leased stock pens, office space, and other equipment.

The result of these findings was an increased demand for governmental control of the packing industry. The agitation culminated in the enactment of the Packers and Stockyards Act of 1921 and in the issuance by a Federal court of the consent decree of 1920, which placed restrictions upon the freedom of action of the five large packing companies.

As its name indicates, the Packers and Stockyards Act is divided into two parts, one dealing with packers and the other with stockyards. The act endeavors to do two things. In the first place, it strengthens the Sherman Law by providing more specific prohibitions against monopoly and restraint of trade in the packing industry. In the second place, it recognizes that the stockyards are businesses affected with a public interest and regulates rates, prohibits discrimination, and imposes on stockyards the obligation to serve without discrimination.

After defining the word "packer," the act makes it unlawful for a packer to engage in any unfair, discriminatory, or deceptive practice; to give any undue or unreasonable preference to any person or locality; to sell, transfer, buy, or receive from any other packer any article for the purpose of or with the effect of apportioning the supply in commerce, if such apportionment has the tendency or the effect of restraining commerce or creating a monopoly; to engage in any course of business for the purpose of or with the effect of manipulating or controlling prices, restraining trade, or creating a monopoly in any article in commerce; or to conspire, combine, or agree with any person to apportion territory, purchases, or sales in commerce.[6]

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to half a day after they are sold before we can get them weighed. They own the scales. As soon as they get the cattle in their hands they have got you. They weigh them when they feel like it, and this gives them a chance to take advantage of the producer, inasmuch as it is to their advantage to get as much shrink off the producer as they can before the cattle are weighed to them. In my opinion a steer after he has been fed and watered will shrink 15 pounds the first hour he stands, 10 pounds the next hour, 5 pounds the next hour, and some more for each hour thereafter, especially if they are moved about."

[6] U. S. Code, Title 7, Secs. 191 and 192.

The act states that whenever the secretary of agriculture has reason to believe that any packer has violated or is violating any of the provisions of the law he shall cause a complaint to be served setting forth the charges and shall require the offending party to attend and testify at a hearing. If it is found that the packer has violated any provision of the act, the secretary of agriculture is to issue an order "to cease and desist." This order is final and conclusive unless within 30 days after service the packer requests that a circuit court of appeals review the decision. Such court may affirm, modify, or set aside the order of the secretary of agriculture. If the court affirms or modifies the order, its decree operates as an injunction to restrain the packer from perpetrating the prohibited act. Fines and imprisonment are provided for the violation of an order of the secretary which has been upheld by the courts.[7]

The act then proceeds to define and make regulations for stockyards. A stockyard whose area is less than 20,000 square feet is exempted. The secretary of agriculture is to determine whether or not a stockyard comes within the act and to give the required notice. No person is allowed to carry on the business of a "market agency" or a dealer at one of the designated stockyards unless he has registered with the secretary of agriculture. All rates and charges must be reasonable and nondiscriminatory. Stockyard owners and "market agencies" must file with the secretary of agriculture and keep open to public inspection their schedules of rates and charges. No changes may be made in rates or charges except after 10 days' notice to the secretary of agriculture and to the public. Finally, it is the duty of every stockyard owner or market agency to furnish reasonable services and to establish, to observe, and to enforce just, reasonable, and nondiscriminatory regulations and practices with respect to the furnishing of these services.[8] Every packer, stockyard owner, market agency, or dealer must keep such accounts, records, or memoranda as will disclose completely and correctly all transactions in his business.[9]

The act gives to the secretary of agriculture certain powers of enforcing the provisions pertaining to stockyards. It is his duty

[7] U. S. Code, Title 7, Secs. 193–195.
[8] U. S. Code, Title 7, Secs. 202–208.
[9] U. S. Code, Title 7, Sec. 221.

to determine which stockyards come within the act, to give them notices, and to post copies of such notices at the yards themselves so that the public may be informed.[10] Furthermore, the secretary of agriculture, after a hearing upon complaint or upon his own initiative, may prescribe just, reasonable, and nondiscriminatory maximum, minimum, or absolute rates; and may prescribe also just, reasonable, and nondiscriminatory regulations, or practices.[11] Any stockyard owner, market agency, or dealer who knowingly fails to obey an order of the secretary of agriculture under this provision of the act is to forfeit to the United States a sum of $500 for each offense. These forfeitures are recoverable in civil suits by the United States. Each distinct violation is made a separate offense, and in case of continuing violations each day is considered a separate offense. If any stockyard owner, market agency, or dealer violates an order of the secretary of agriculture made under the provisions of the act, the attorney general or an injured party may apply to a district court for enforcement of the order. If the court determines that the order has been lawfully made, the court is required to enforce the order by a proper writ. Provision is made also for setting aside the orders of the secretary of agriculture.[12]

In carrying out the rate provisions of the Packers and Stockyards Act the secretary of agriculture has in general followed the same techniques and used the same principles which are followed by public service commissions in fixing rates for public utilities. For example, the secretary of agriculture found that rates at the stockyards in Denver were unreasonable because marketing charges for feed and bedding for livestock were too high. The secretary of agriculture then proceeded to determine just and reasonable rates. The secretary made a valuation based upon the cost of reproduction new less depreciation of the structures and other tangible personal property at the stockyards, plus the present value of the land. Then after allowing reasonable operating expenses, he fixed rates so as to permit a 6 per cent return on the value of the stockyards.[13]

[10] U. S. Code, Title 7, Sec. 202(b).

[11] U. S. Code, Title 7, Sec. 211.

[12] U. S. Code, Title 7, Secs. 215–217.

[13] Denver Union Stockyard Co. v. U. S. (1938) 304 U. S. 470, 82 L. Ed. 1469, 58 S. Ct. 990.

Although the Packers and Stockyards Act designates the secretary of agriculture as the agent who is to enforce its provisions, most of the work is performed by the Packers and Stockyards Division of the Bureau of Animal Industry.[14] In its administration of the act the Packers and Stockyards Division has tried to foster self-regulation. On Oct. 22, 1929, at the invitation of the secretary of agriculture, a "trade practice conference" of the meat-packing and wholesale meat industry was held in Chicago. At this conference, which represented 95 per cent of the entire industry, a number of important resolutions were adopted. These were subsequently approved by the secretary of agriculture, who made the statement that his department would take such action as the law warranted with respect to violations of these resolutions.[15]

Since the enactment of the Packers and Stockyards Act two important cases upholding the constitutionality of its provisions have been decided by the Supreme Court. In the first of these decisions, *Stafford v. Wallace*, the constitutionality of the act was challenged upon the grounds that it regulated the buying and selling of cattle at particular stockyards and that such transactions were not interstate commerce. But the Supreme Court held that the entire movement of cattle from one part of the country to another through the stockyards and packing plants was interstate commerce and that transactions, such as the buying or selling which took place at various stages during the entire movement of the commodities, were merely parts of or closely allied to such movement and hence subject to congressional regulation.[16]

In the second decision, *Tagg Brothers and Moorhead v. United States*, the constitutionality of the section giving the secretary of agriculture the power to fix charges for the services of commission men located at the stockyards was challenged upon the grounds that it was a violation of the Fifth Amendment. The plaintiffs argued that the government was not fixing rates for the use of property affected with a public interest but was regulating charges for the personal services of commission men who used no property in their business except horses and desks.

[14] See Annual Report of the Bureau of Animal Industry, 1930, p. 46.

[15] See Annual Report of the Bureau of Animal Industry, 1930, p. 49.

[16] Stafford v. Wallace (1922) 258 U. S. 495, 66 L. Ed. 735, 42 S. Ct. 397.

The plaintiffs contended that there was a vital distinction between property and its use, and personal services. Property originated with the state and reverted to the state; whereas freedom of contract was a prerequisite to the very organization of government. Furthermore, they alleged that it was impossible to ascertain what was a fair return for personal services because liberty, unlike property, had no equivalent in money. Finally, the plaintiffs contended that, although property might be taken for public use upon the payment of just compensation, personal services could not be said to be dedicated to public use and therefore could not be taken except in time of war or as punishment for crime.

The court answered these contentions by declaring that there was nothing in the nature of monopolistic *services* which made it impossible to fix reasonable charges therefor. The sole question was whether or not the business was one affected with a public interest. Whether the business could be so classified depended, not upon the amount of capital employed, but upon the character of the service. In the case before the court, the plaintiff was performing an indispensable service and was enjoying a substantial monopoly through the maintenance of uniform charges. These characteristics stamped the business as one affected with a public interest and subject to the regulations imposed.[17]

In addition to the Packers and Stockyards Act, the investigations of the packing industry by the Federal Trade Commission resulted in a "consent decree" entered into in 1920 by the "big five," Swift, Armour, Wilson, Morris, and Cudahy. Action was commenced under the Sherman Antitrust Law for a violation of its provisions. The packers, thinking perhaps that the government had some very cogent evidence or desiring to retain the good will of the public, submitted to a consent decree. This decree forbade the "big five" to hold any interest in public stockyard companies, terminal railways, or market newspapers; to engage in or hold any interest in the business of manufacturing or selling certain food products unrelated to the meat-packing industry, or to use or permit others to use their distributive facilities for such products; to operate retail meat markets; to

[17] Tagg Bros. and Moorhead v. U. S. (1930) 280 U. S. 420, 74 L. Ed. 524, 50 S. Ct. 220.

sell fresh milk and cream; or to hold any interest in public cold storage plants.[18]

Several attempts were made to secure a modification of this decree. Finally, in January, 1931, the Supreme Court of the District of Columbia handed down a decision which modified it in certain important particulars. Permission was given to Swift and Armour to manufacture and to engage in the wholesale distribution of certain food products unrelated to meats and to use their distribution facilities in handling these commodities. The Supreme Court of the United States subsequently reversed this decision and reaffirmed the consent decree of 1920.[19]

II. Regulation of Commodity Futures.

A "futures contract" is an agreement on the part of the seller to deliver and on the part of the buyer to receive and pay a certain price for a certain kind and quantity of a commodity at some specified future time. Trading in futures is confined largely to agricultural commodities, such as wheat, corn, oats, rye, barley, cotton, flaxseed, butter, eggs, and potatoes. Not every agricultural commodity is suitable for future trading. To be a proper commodity for this kind of transaction it must have certain qualifications. It must be homogeneous, it must be susceptible to grading, it must be sufficiently durable to last throughout the life of the "future," it must be dealt with in sufficiently large quantities to support the cost of the facilities required, and it must be sold at a market large enough to attract widespread groups of persons. Buying and selling of futures resembles a kind of enlarged auction. Exchange members gather on the trading floor to negotiate through oral bids for the purchase and sale of specified commodities. The agreements which are made are contracts of a peculiar type called "futures." Fulfillment of a futures contract is accomplished in one of two ways: it may be completed by tender and delivery of the quantity and quality of the commodity specified; it may be fulfilled by an offsetting transaction in which there is a substitution of principals and an adjustment of price differences, usually through the medium of a clearing association. The latter kind of settlements greatly exceeds in number those brought about by a transfer

[18] See case referred to in footnote 19.

[19] U. S. v. Swift and Co. (1931) 286 U. S. 106, 76 L. Ed. 999, 52 S. Ct. 460.

of ownership of the actual commodity. All agreements to sell and to buy are pooled. The clearing association assumes the dual position of seller to all buyers and buyer to all sellers. The result is that members of the clearing association who have bought and sold like quantities hold offsetting contracts with a single principal, namely, the clearing association. Their contracts can be satisfied by paying to or receiving from the association the difference in value due to the difference in price.[20]

Trading in grain futures is supposed to have originated in Chicago prior to the Civil War as an outgrowth of dealing in time contracts. Some of these contracts were recorded as early as 1848. In the early history of the Chicago Board of Trade, sales for deferred shipments were dependent upon navigation on the Great Lakes. During the winter, when navigation was closed, sales were made for shipment at the opening of navigation, which was usually in May. This led to trading in contracts for delivery in May. These contracts usually changed hands a number of times. Likewise, prices fluctuated during the period when navigation was closed, thus affording opportunities for speculation as well as placing heavy risks upon those who assumed the ownership of grain. By 1865 the rules of the Chicago Board of Trade recognized trading in grain futures as a distinct commercial practice.[21] Dealings in grain futures increased until traders were buying and selling on the average of more than 16,000,000,000 bushels a year from 1927 to 1936.

The system of future trading now extends to all months of the year, although the trading in grain futures is confined largely to futures for the months of May, December, July, September, and March.

The buying and selling of futures has given rise to considerable opportunity for speculation. At the time of the Civil War, speculation was supposed to have reached considerable proportions. The period which immediately followed the World War was another era of tremendous speculation in futures. During the World War the Federal government controlled wheat prices and forbade future trading. When government restrictions

[20] See Annual Report of the Commodity Exchange Administration, 1937, p. 4.

[21] See the article in the *U. S. Daily* by J. W. T. Duvel, Aug. 8, 1931, p. 8. See Annual Report of the Commodity Exchange Administration, 1937, p. 1.

were removed, violent fluctuations and severe drops in the price of grain occurred. These probably were, to a certain extent, the result of speculation on the boards of trade. Big traders were forcing down prices and reaping a profit at the expense of the farmers. There was much buying and selling of futures during this period. In 1920 the corn crop of 3,000,000,000 bushels was sold three times before a single bushel ever reached the market.[22]

As a result, the agitation to regulate the buying and selling of grain futures grew by leaps and bounds. There were many persons who advocated the complete elimination of the sales of grain futures on the ground that such transactions did not have a legitimate place in the grain trade. Another group pointed out, however, that dealing in grain futures was desirable because it provided a continuous market for the buying and selling of these commodities, because it aided in determining prices, and because it gave an opportunity for "hedging," a practice which was important to the trade.[23]

Hedging has been described as a form of protection against the risk of price changes by offsetting one transaction against another involving risks of an opposite character. The question naturally arises as to what persons engage in hedging and what is its relationship to commodity futures? A merchant or an elevator operator who has to carry a stock of grain protects himself against a decline in prices by selling for future delivery a quantity equal to the amount which he holds. A manufacturer who has contracted to deliver a product, such as flour, protects himself against the rising price of wheat by buying for future delivery a quantity of wheat equal to that which he intends to use. When the transaction of either the elevator operator or the manufacturer is completed (but not necessarily at the time of the fulfillment of the futures contract), that is, in the first case by selling the stock of grain and in the second case by buying the wheat, the original transaction in the futures market is reversed.[24]

In making regulations for trading in futures, the Federal government has not prohibited the practice but has merely sought

[22] See the articles in 37 *Quarterly Journal of Economics* 687; 46 *World's Work* 425; 15 *Current History* 975.

[23] See Annual Report of the Commodity Exchange Administration, 1937, p. 4.

[24] See the *Encyclopaedia of the Social Sciences*, Vol. 7, pp. 305 and 306.

to control and prevent some of the worst abuses in the trade. The first attempt was through the so-called Future Trading Act of 1921. Briefly, this law imposed a tax of 20 cents a bushel on contracts for the sale of grain for future delivery. An exception was made, however, for sales which took place upon boards of trade which were designated by the secretary of agriculture as "contract markets." The Supreme Court of the United States held that the Future Trading Act was unconstitutional because it did not represent a valid exercise of the taxing power. Its purpose, which was obvious on the face of the act, was to regulate boards of trade and the transactions of their members.[25]

The Future Trading Act was followed by the Grain Futures Act of 1922. This time, however, in order to achieve its purpose, Congress made use of the "commerce clause" of the Constitution instead of the "taxing clause." To meet possible judicial objections to the constitutionality of the Grain Futures Act, Congress stated in the first section that it was enacted to prevent obstructions to and burdens upon interstate commerce. The constitutionality of the Grain Futures Act was upheld by the Supreme Court in *Board of Trade v. Olsen.* In that case opponents of the act argued that it was not a regulation of interstate commerce but that it was a regulation of transactions which took place entirely within a state and which were local in character, namely, the buying and selling of grain futures. The Supreme Court held, however, that the whole movement of grain throughout the United States was interstate commerce, that the dealings in grain futures were merely incidental to or closely connected with such commerce, and that the purpose of Congress as stated in the preamble of the act was to prevent certain constantly recurring abuses which constituted a burden upon and an obstruction to such commerce in grain.[26]

The Grain Futures Act made it unlawful for any person to use the mails or other interstate communication for the sales of *grain* futures except through members of a board of trade which had been designated as a "contract market." The secretary of agriculture could designate any board of trade as a contract market if it met certain requirements. Among other things, the governing body of the board of trade was required to provide

[25] Hill v. Wallace (1922) 259 U. S. 44, 66 L. Ed. 822, 42 S. Ct. 453.

[26] Board of Trade v. Olsen (1923) 262 U. S. 1, 67 L. Ed. 839, 43 S. Ct. 470.

for the making and filing of reports containing details of all transactions on the market; was required to provide for the prevention of the dissemination of false or misleading crop or market information, the manipulation of prices, or the cornering of grain by dealers on the board of trade; and was forbidden to exclude from membership or privileges the representatives of cooperative associations.[27]

Under the Grain Futures Act a commission composed of the secretary of agriculture, the secretary of commerce, and the attorney general was authorized to suspend or revoke the designation of any board of trade as a "contract market" if the board of trade failed to comply with the above-mentioned requirements. Such revocation or suspension was to be final unless an appeal was taken to the Circuit Court of Appeals.[28] One attempt was made by the government to suspend the operations of the Chicago Board of Trade for an alleged refusal to allow a cooperative association certain privileges to which it claimed to be entitled under the act. This action was appealed to a circuit court of appeals, which reversed the action of the government in suspending the Chicago Board of Trade.[29]

Attempts were made to amend the Grain Futures Act, but none were successful until 1936. In that year Congress enacted the Commodity Exchange Act, which made substantial alterations in the Grain Futures Act.

The detailed administration of the Commodity Exchange Act has been entrusted to the Commodity Exchange Administration of the Department of Agriculture. In certain things, such as revoking or suspending the license of a board of trade or issuing an order to cease and desist, a commission composed of the secretary of agriculture, the secretary of commerce, and the attorney general must act.

The Commodity Exchange Act places under governmental control several commodities not included under the Grain Futures Act. The Commodity Exchange Act covers futures in wheat, cotton, rice, corn, oats, barley, flax seed, grain sorghum, mill feeds, butter, eggs, and Irish potatoes.[30]

[27] U. S. Code, Title 7, Secs. 6 and 7.

[28] U. S. Code, Title 7, Sec. 8.

[29] Board of Trade v. Wallace (1933) 67 Fed. 2d 402.

[30] Public Act No. 675, 74th Congress, Sec. 3 (a), approved June 15, 1936.

The act requires that an exchange must register and be designated as a contract market.[31] The following sixteen commodity exchanges have now been designated as contract markets.[32]

CONTRACT MARKET	COMMODITY
Chicago Board of Trade	Wheat, corn, oats, barley, cotton
Chicago Mercantile Exchange	Butter, eggs, potatoes
Chicago Open Board of Trade	Wheat, corn, oats, rye
Duluth Board of Trade	Wheat, rye, flaxseed
Kansas City Board of Trade	Wheat, corn, oats, mill feeds
Los Angeles Grain Exchange	Barley
Milwaukee Grain and Stock Exchange	Wheat, corn, oats, rye
Minneapolis Chamber of Commerce	Wheat, corn, oats, rye, barley, flaxseed
New Orleans Cotton Exchange	Cotton
New York Cotton Exchange	Cotton
New York Mercantile Exchange	Butter, eggs
New York Produce Exchange	No trading under the act since 1932
Portland Grain Exchange	Wheat
St. Louis Merchants Exchange	Wheat, corn, oats, mill feeds
San Francisco Chamber of Commerce	Barley
Seattle Grain Exchange	Wheat

Every contract market must furnish copies of its bylaws and rules and regulations, must allow inspection of its books, and must keep its records in a form prescribed by the Commodity Exchange Administration.[33]

The act requires the registration of all futures commission merchants and all floor brokers. Each person who has registered is required to furnish the secretary of agriculture with certain information concerning the conduct of his business.[34]

The Commodity Exchange Act adds to the Grain Futures Act some regulations which are designed to prevent manipulation of prices. The Grain Futures Act provided that a board of trade was to prohibit manipulation and the dissemination of false and misleading information. This provision has been retained and others added which are directed to individual traders. The act provides that it is unlawful for any member of a contract market to cheat or defraud, to make false reports willfully, to enter into

[31] U. S. Code, Title 7, Sec. 6.

[32] See Annual Report of the Commodity Exchange Administration, 1937, p. 15.

[33] Public Act No. 675, 74th Congress, Sec. 7.

[34] Public Act No. 675, 74th Congress, Sec. 5.

"wash sales" or other fictitious sales, or to enter into any transaction if the price recorded is not a true and bona fide price. The act also requires every futures commission merchant to treat as belonging to the customer all money, security, and property of the customer which is given to margin, guarantee, or secure the customer's contracts.[35]

The Commodity Exchange Act gives to the administration some authority to prevent excessive speculation. The administration may from time to time fix limits on the amount of trading which may be done by any person under contract for the sale of a commodity for future delivery.[36]

The act provides several methods of enforcing its provisions. For violation of the act or rules and regulations made thereunder the commission (the secretary of agriculture, the secretary of commerce, and the attorney general) may issue an order to cease and desist against a board of trade, or against any of its agents, officers, or employees. If a person or a board of trade fails to comply with the order, he is guilty of a misdemeanor and may be fined or imprisoned.[37] If any commission merchant or floor broker violates any of the provisions of the act or any rule or regulation of the Commodity Exchange Administration, such person may have his registration suspended or revoked.[38] Finally, if any board of trade refuses to comply with any of the provisions of the act or any rules or regulations made thereunder, the commission may suspend its operation as a contract market for a period not to exceed six months or may revoke the designation of the board of trade as a contract market.[39]

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[35] Public Act No. 675, 74th Congress, Sec. 5.

[36] Public Act No. 675, 74th Congress, Sec. 5. The Commodity Exchange Administration issued an order in December, 1938 fixing limits on the amount of trading which could be done by one person. See *The Federal Register*, Dec. 24, 1938, p. 3145.

[37] Public Act No. 675, 74th Congress, Sec. 9.

[38] Public Act No. 675, 74th Congress, Sec. 5.

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CHAPTER XVIII

REGULATION OF SECURITIES

During the nineteenth and early part of the twentieth century, the regulation of securities was not a problem of much importance. The number of stocks and bonds in existence was not great. Besides, they were owned by a relatively small group of people. In the period which followed the World War the number of corporations increased and the public became "security minded." Promoters, sensing this increased interest, poured forth quantities of securities in order to satisfy the aroused speculative appetite of the American public. Unfortunately, many issues of stocks and bonds were fraudulent and others were highly speculative.

As a result of the great increase in the number of securities and the number of security holders, the problem of governmental control became one of importance. It has been estimated that of 48 large companies in existence in 1931, 88 per cent of the stock was owned by persons holding fewer than 100 shares. The millions of small investors knew little of the stocks and bonds in which they were investing and were ready prey to the operations of unscrupulous promoters. Even reputable banking houses were sometimes none too careful to investigate the merits of stocks and bonds which they recommended to their clients. Many issues of foreign bonds which were ultimately repudiated were sold in this country on the recommendation of reputable financial houses.[1] Furthermore, "insiders" were sometimes given advantages which enabled them to enrich themselves unjustly through stock deals at the expense of the public. Corporations would issue new stock or options to purchase new stock to a selected group of persons at a certain price and then at a later date would place the rest of the stock on the

[1] See Hearings before the Committee on Banking and Currency, United States Senate, 73d Congress, 2d Session, S. Res. 84, Part 4, p. 1893 and p. 1958, and Part 6, p. 2749.

market at a higher price.[2] Persons thus favorably situated would be able to make a large profit without effort on their part.

Not only were there undesirable practices in the issuance and sale of new stocks and bonds, but there were also many in the sale of existing stocks and bonds on the security exchanges throughout the United States. A stock market is a place for the purchase and sale by the public of a certain kind of property. Transactions and prices should reflect as nearly as possible the value of the stocks and bonds which are listed on the exchanges. Unfortunately, many times prices have been the result of artificial manipulation designed to enrich a small group of promoters.

One of the devices which was sometimes used to manipulate the market was the so-called "wash sale." In this case, one broker agreed to sell a certain type of security at a point higher than it commanded at that time on the open market. Another broker agreed to buy that type of security. Actually, however, neither had any intention of exchanging the stock or paying the money. This type of fictitious transaction led the public to believe that the price of the stock was rising and thereby induced persons to buy. A "matched order" was another type of fictitious transaction which was used to stimulate market activity. In this case an individual or group of individuals would hire two brokers unknown to each other and would order one of the brokers to sell a certain security at a certain price and the other to buy that security at the same price. This procedure gave the appearance of great activity in that security and thereby induced persons to buy. These purchases by the public boosted the price and gave the operators a chance to sell their holdings at a profit.[3]

One of the most important ways by which prices were manipulated was through publicity. Through newspapers, over the radio, and in other ways the public would be informed about a certain stock and its possibilities. Sometimes operators even subsidized column writers of financial pages to boost stock which the operators wished to manipulate.

[2] See Hearings before the Committee on Banking and Currency, United States Senate, 73d Congress, 2d Session, S. Res. 84, Part 1, p. 216.

[3] For a brief statement of the nature of "matched orders" and "wash sales" see *U. S. News*, Feb. 19, 1934, p. 8.

During the stock market boom which ended in 1929 a number of so-called pools were formed to concentrate on certain stocks and, through manipulation, to make large profits for their members. Such pools were formed for the purpose of acquiring, either by purchase in the open market or through options, blocks of securities to be later unloaded at a profit. Often pools operated for legitimate purposes and in legitimate ways, but sometimes they were designed merely to make a profit as the result of speculation planned in advance. The so-called bear and bull pools furnish illustrations of pools of the speculative type. A bear pool is a combination to sell a security short and then buy at depressed prices. A bull pool is formed to acquire stock and then unload at marked-up prices.[4]

One of the best known pools in recent years was the "radio pool" which was organized in March, 1929. In a short period of time (its major operations covered a little over a week) the organizers of this pool were alleged to have made a profit of $5,000,000.[5] The organizers bought a block of stock. This purchase stimulated interest, the public began to buy, and the price climbed rapidly. The pool bought and sold stock and manipulated the market in order to stimulate greater interest. Finally when the operators thought the price of the stock had reached its peak, the pool slowly unloaded all of its holdings and the price of shares in the hands of the public fell to a normal market level. It is interesting to note that during the period of activity of the radio pool many leading and optimistic statements were made in New York papers concerning the outlook for Radio Corporation.

Another practice which gave rise to much criticism was that of trading on margins. In margin trading the person who wishes to purchase stock does not buy outright for cash but merely gives his broker a certain percentage of the price of the stock. The broker then borrows the balance from a bank, which takes the stock as security.[6] The person who purchases stock on a margin is not usually interested in purchasing for an investment but in buying the stock for speculative purposes, hoping that the price

[4] See "Market Manipulation and the Exchange Act" by Moore and Wiseman, 2 *University of Chicago Law Review* 46(51), footnote 27.

[5] "Stock Market Control," Twentieth Century Fund Incorporated, pp. 109–110.

[6] "Stock Market Control," Twentieth Century Fund Incorporated, p. 60.

will rise and that he will be able to sell in the near future at a profit. If the margin on which a buyer operates is small and a large number of persons operate on a margin in a market, this will artificially stimulate prices and lead to fluctuations which do not reflect the true value of stocks.

The many abuses which had crept into the issuance and sale of securities led to a demand for reform and for legislation to curb some of the practices. That it is desirable for the government to protect persons against fraud in the sale of stocks and bonds is not debatable. The control of securities is also desirable from a social and economic point of view. To allow a few persons, through manipulation of the markets or the sale of securities, to enrich themselves at the expense of the many merely aggravates one of our greatest problems, the maldistribution of wealth. Furthermore, such a speculative boom as that which ended with the stock market crash of 1929 is detrimental to our social and economic structure and should, if possible, be held within reasonable bounds.

Both Federal and state governments, realizing the importance of controlling securities, have adopted laws designed to curb some of the worst abuses which have crept into the issuing and the buying and selling of stocks and bonds. The topic of regulation of securities may be divided into three parts: (1) state control of security issues, (2) Federal control of security issues, and (3) Federal regulation of security exchanges.

I. State Regulation of the Issuance of Securities.

The so-called "blue sky" laws, under which states have attempted to control the issuance of securities, may be said to have had their beginnings in an act of Kansas in 1911.[7] The movement to protect the investing public did not gain much impetus until after the World War, when several of the states enacted security legislation. Many of these laws were strengthened and others passed after the stock market crash in 1929. At present, 47 of the 48 states offer the investor some protection against securities of doubtful value. Nevada is the only state which does not in any way regulate the sale of securities.[8] In

[7] Laws of Kansas, 1911, Chap. 133.

[8] See *State Governments*, published by the Council of State Governments, March, 1936, p. 58.

general, the laws of the states may be divided into three groups: fraud statutes; statutes licensing brokers, agents, and salesmen; and statutes which provide for the registration of securities. Four states—Maryland, Delaware, New Jersey, and New York—rely solely upon fraud statutes. Connecticut, Maine, Pennsylvania, and Rhode Island depend entirely upon dealer-licensing laws. All of the others use laws providing for the registration of securities, and some of these also require the licensing of brokers, agents, and salesmen.[9]

The fraud statute of Maryland is typical of this type of regulation. If it appears to the attorney general that the methods of sale or advertising of securities are fraduluent, he is to investigate the books and persons involved. In the case of fraudulent practices he can issue an order to cease and desist. For violation of the order a person may be fined $10,000, imprisoned for two years, or both.[10] Fraud statutes are subject to the objection that they seek to remedy a wrong after damage has been done. Authorities who enforce the act investigate stocks or bonds which are already being sold or which have been sold and by administrative order or court injunction prohibit further sale of issues which are fraudulent or suspected of being fraudulent. Obviously, considerable damage may have been done to investors before the fraud is discovered and prohibitory action taken by state authorities.

Statutes licensing persons who sell securities are more common than fraud statutes although, as previously stated, few states rely solely upon this method of regulation.[11] Although there is some difference in the statutory provisions of the various states, as a rule these statutes require dealers, brokers, agents, and salesmen to register and secure licenses. A license may be refused for various reasons. For example, under the Florida statute the applicant may be refused a license or may have his license revoked if, among other things, he has violated any provision of the securities law or any regulation made thereunder, has made any materially false statement in the application for registration, has been guilty of a fraudulent act in the sale

[9] See *State Governments*, published by the Council of State Governments, March, 1936, p. 58.

[10] Annotated Code of Maryland, Bagby, Vol. I, pp. 1212–1214.

[11] Revised Statutes of Maine, 1930, Chap. 57, Sec. 162.

of securities, or has demonstrated his unworthiness to transact the business of dealer or salesman.[12]

As a rule, such registration or license is issued for one year only and must be renewed at its expiration if the dealer or broker wishes to continue to sell securities. Most states provide that a license may be revoked on grounds similar to those for which it may be refused.[13] Because of the comparatively short period for the duration of the license and the rather complicated procedure usually required to revoke, the provisions for revocation are not frequently employed. Undoubtedly, however, the mere existence of the power to revoke serves as a reasonably effective deterrent. Control of securities through the registration of dealers and brokers is open to the same objection which can be raised against fraud statutes. Considerable damage may be done to investors through the sale of worthless stocks and bonds by licensed dealers before action to revoke a license can be taken by state authorities to protect investors.

The most common and the most effective method of regulation is the requirement now found in most states that securities must be registered before they may be sold to the public. The typical "blue sky" laws are of this character. The administration of these acts has been entrusted to many different officers or bodies. In some states the registration of securites has been placed under the jurisdiction of a bank commission, in others a securities commission or a corporation commission. In a few states the registration has been given to a department of law or a department of finance. Very frequently the registration is through the office of the secretary of state.

As a rule the term "security" is given a broad definition, including stocks, bonds, notes, debentures, commercial paper, investment contracts, interests in trusts, or other evidences of indebtedness.[14] In some of the mining states it includes any certificate of interest in gas, oil, or mining leases.[15] In a few states the term "security" covers contracts or bonds for the sale and conveyance of land which lies outside the state and which has been sold on deferred payments or on the installment plan.[16]

[12] Laws of Florida, 1933, Chap. 17253, Sec. 12.

[13] See Code of Iowa, 1935, Chap. 393, Sec. 8581-C13.

[14] Mason's Minnesota Statutes, 1927, Sec. 3996-1.

[15] Carroll's Kentucky Statutes, Baldwin's 1936 revision, Sec. 165a-23.

[16] Virginia Code of 1936, Title 34A, Chap. 147A, Sec. 3848(48).

In states which have registration laws no securities may be sold except those which are exempt unless the securities have been registered with the proper authority. Application for a permit to sell the securities must contain certain information required by statute or the rules of a commission, or by other state authority. The various securities acts usually contain a rather long list of securities which are exempt from their provisions. In general, these exemptions cover five classes of securities: (1) those which are issued by various governmental units—the United States, the states, municipalities, or foreign governments; (2) those which are issued by companies organized for charitable, benevolent, or educational purposes; (3) those the issuance of which is supervised by some other governmental agency, such as stocks and bonds of public utilities, railroads, banks, building and loan associations, and policy contracts of insurance companies; (4) commercial paper maturing in less than six months or a year; and (5) securities listed on exchanges in certain large cities and approved by such exchanges.[17] Some of the agricultural states add to the list of exempt securities those issued by cooperative associations which are engaged in raising, marketing, or manufacturing farm products.[18] In addition to exempting certain securities the laws of most of the states also exempt certain transactions involving securities, such as judicial or administrative sales, distribution by a corporation of capital stock or other securities to its stockholders as dividends, sales of securities to banks, trust companies, dealers, or brokers, the issuance of securities by a company to its creditors in the process of a bona fide reorganization, and the sale of securities in isolated transactions.[19]

Unless a security belongs to one of the classes exempt from registration or unless a transaction involving its transfer is one which is exempt, the security must be registered before it may be sold or transferred.[20] Some states provide for two methods of registration, *registration by notification* and *registration by qualification*. In registration by notification, individuals or corporations wishing to issue and to sell securities may do so immediately

[17] Mason's Minnesota Statutes, 1927, Sec. 3996-2, as amended by Laws of Minnesota, 1933, Chap. 408, Sec. 4.

[18] Code of Iowa, 1935, Sec. 8581-c4j.

[19] Mason's Minnesota Statutes, 1927, Sec. 3996-3.

[20] Compiled Statutes of Nebraska, 1929, Art. 54, Secs. 81–5404.

after filing certain information with the proper state authority. It is unnecessary for the applicant to wait for an investigation or permission to sell. Obviously, if the regulation of securities is to be effective, such an easy method of registration cannot be generally allowed. As a rule, registration by notification is permitted in only a few cases, such as the issuance of stock by corporations which have operated for a certain number of years and have consistently paid dividends during that period of time, or the issuance of bonds secured by first mortgages on property where the bonds do not exceed 70 per cent of the value.[21]

Registration by qualification is required before the issuance and sale of most securities. An application containing the required information must be filed with a commission or other state authority. After the investigation, approval is either given or withheld. The statutes of the different states contain various grounds upon which the proper authority may approve or disapprove the registration. In Oklahoma the commissioner is to record the registration if he finds that the sale of a security would not be fraudulent or the enterprise is not based upon unsound business principles.[22]

Even with such protection as that afforded by laws requiring registration of securities, it may become necessary for the state to protect further the investing public by providing for the revocation of the registration of securities. In Minnesota, after notice and hearing, the registration of securities may be revoked because the security is fraudulent, because further sale would work a fraud on the purchaser, because a person has violated or is about to violate the securities law or the rules of the commission, or for good cause appearing to the commission.[23]

II. Federal Regulation of the Issuance of Securities.

If the investing public is to be protected adequately, reliance cannot be placed entirely upon state control. Although by 1933 nearly all states had some kind of regulation of securities, many of them did not have adequate legislation. Promoters who wished to issue doubtful securities could have done so in those states in which the laws were most lax. Adequate regula-

[21] See Laws of Florida, 1931, Chap. 14899, Sec. 7.

[22] Oklahoma Session Laws of 1933, Chap. 121, Secs. 5 and 6.

[23] Mason's Minnesota Statutes, 1927, Sec. 3996-8.

tion of securities demanded control by both Federal and state governments.

In 1933 Congress enacted the Federal Securities Act, which provided for the registration of securities. At first, the administration of the Act was given to the Federal Trade Commission. In 1934 the task of supervising registration was taken from the Federal Trade Commission and given to the newly-created Securities and Exchange Commission.

Persons who advocated Federal regulation of securities were faced with certain constitutional difficulties. There was great doubt as to whether or not the issuance of or the buying and selling of stocks and bonds was interstate commerce. The Supreme Court of the United States had decided that the buying and selling of bills of exchange was not commerce and also that the business of insurance was not commerce.[24] These decisions seemed to indicate that the mere purchase and sale or the issuance of securities would probably not be considered commerce by the courts. However, telephone and telegraph communication between states had been held to be interstate commerce and hence under the jurisdiction of the Federal government. Likewise, the transportation of the mails was controlled by the Federal government. Therefore, in order to keep clearly within constitutional limits, Congress forbade the use of the facilities of interstate commerce or the mails to those who sold securities but who did not comply with the regulations imposed by Congress. According to the Securities Act of 1933 it is unlawful to make use of the mails or interstate commerce to sell or transport securities unless they have been *registered* with the Securities and Exchange Commission. Likewise, it is unlawful to carry or transmit a prospectus in interstate commerce or through the mails unless the prospectus meets the requirements of the act. Furthermore, it is unlawful to carry or cause to be carried through the mails or interstate commerce any security for the purpose of sale or delivery after sale unless accompanied by a prospectus.[25]

A security may be registered with the Securities and Exchange Commission by filing a registration statement. Ordinarily the statement must be signed by the issuer, the principal executive

[24] Paul v. Va. (1869) 8 Wall. 168, 19 L. Ed. 357; Nathan v. La. (1850) 8 How. 73, 12 L. Ed. 992.

[25] U. S. Code, Title 15, Sec. 77e.

officer, the principal financial officer, the principal accounting officer, and a majority of the board of directors.[26] If issued by a foreign government, the registration statement need be signed only by the underwriter. One of the chief purposes of the Securities Act is to give to the commission and prospective purchasers detailed and accurate information concerning the corporation issuing the securities and the securities themselves. The act is definite as to the information which must be placed in the registration statement. Names and addresses of directors, officers, promoters, underwriters, and owners of more than 10 per cent of the outstanding stock must be given. Also the amount of stock held by these persons is to be listed.

The act also requires information concerning the business and capitalization of the company, any options on the stock which is being issued, the amount of the capital stock of each class included in the shares which are being offered, the indebtedness of the company, the purposes for which the money raised by the securities is to be used, the salaries and remuneration paid to directors and officers, the price at which the security is to be offered to the public, the commissions and discounts paid to underwriters, expenses incurred in connection with the sale of securities, any sums paid to promoters, the names of the sellers of any property or good will which is to be paid for from the proceeds of the security, and a balance sheet and a profit and loss statement in the form prescribed by the commission.[27] If persons who are planning to issue securities furnish accurately the above information, a prospective purchaser of stocks or bonds should be able to obtain complete and detailed knowledge of the corporation issuing the securities and of the securities which he intends to purchase. The rules and regulations of the commission provide that registration statements are to be available for inspection in the office of the commission. In addition, photostatic copies will be sold to the public.[28]

Furthermore, the act itself provides that it is unlawful to send any security through the mails or interstate commerce for the purpose of sale unless accompanied by a *prospectus*. The

[26] U. S. Code, Title 15, Sec. 77f.

[27] U. S. Code, Title 15, Sec. 77aa, Schedule A.

[28] General Rules and Regulations of the Securities and Exchange Commission under the Securities Act of 1933, Rules 120 and 121.

prospectus is supposed to contain in condensed form the information concerning the security and the corporation which is required in the registration statement.[29] The act has been rightly called a "truth-in-securities law." Through the statutory provisions and the rules and regulations of the Securities and Exchange Commission, a vast amount of valuable information is obtained before securities may be issued and this information is placed at the disposal of prospective investors.

In the case of the registration with the Securities and Exchange Commission of bonds which are being issued by foreign governments, the information required by the act is somewhat different from that demanded of corporations. The registration statement must indicate the purposes for which the money derived from the sale of securities is to be used, the amount of debts outstanding, information concerning defaults on foreign securities within 20 years, governmental receipts and expenditures, an estimate of proceeds to be derived from the sale of securities, the price at which the security is to be offered, commissions paid or to be paid, and expenses in connection with floating the securities.[30]

In general, the effective date of the registration statement is the twentieth day after filing. The commission examines the registration statement and if it finds that the statement contains any *untrue* statement of a material fact or omits a statement of any material fact, it may issue a stop order. A person aggrieved by an order of the commission may obtain a review in a circuit court of appeals.[31]

The Federal Securities Act is similar to most of the state laws which require the registration of securities in that it provides for the exemption of several kinds of securities from its provisions. There is considerable similarity between the exemptions in the state laws and those in the Federal statute. The Federal act exempts securities issued by the United States, a state, or political sub-division; certain notes or bills of exchange arising out of current transactions and issued for a short period of time; securities of religious, benevolent, or fraternal organizations; securities of

[29] General Rules and Regulations of the Securities and Exchange Commission under the Securities Act of 1933, Rule 821.

[30] U. S. Code, Title 15, Sec. 77aa, Schedule B.

[31] U. S. Code, Title 15, Secs. 77h and 77i.

building and loan associations provided that the fees do not exceed 3 per cent; securities issued by a railroad under Section 20a of the Interstate Commerce Act; certificates issued by a receiver or trustee in bankruptcy; insurance or endowment policies; securities exchanged by the issuer with existing security holders; securities which are part of an issue sold only to persons resident within a single state if the corporation is incorporated and doing business within that state; and finally those securities which are added to the list by the Securities and Exchange Commission, provided that the issue does not exceed $100,000.[32]

This list offers two interesting and important contrasts to similar exemptions in most state laws. In the first place, this list does not exempt bonds which are issued by foreign governments, whereas most state laws make exceptions for the securities of foreign governments. In the second place, the Federal Securities Act allows the Securities and Exchange Commission to add to the list of exempt securities where the issue does not exceed the $100,000 maximum which has been set by the act. In its rules and regulations the commission has added a number of exemptions. For example, the commission has provided for the exemption of any securities where the aggregate offering price does not exceed the sum of $30,000.[33]

Like the state statutes which provide for the registration of securities, the Federal Securities Act declares that certain transactions involving the purchase and sale or transfer of securities are exempt from its provisions. Transactions by any person other than the issuer, underwriter, or dealer are exempt. Likewise, brokers' transactions executed upon a customer's order on any exchange or in the open or counter market, if not solicited, are exempt.[34]

One of the most interesting features of the Securities Act of 1933 is that which imposes civil liability upon certain persons for false information contained in the registration statement. If a registration statement contains any untrue statement of a material fact or omits to state a required material fact, any person acquiring such security may sue every person who signed

[32] U. S. Code, Title 15, Sec. 77c.

[33] General Rules and Regulations of the Securities and Exchange Commission under the Securities Act of 1933, Rule 200.

[34] U. S. Code, Title 15, Sec. 77d.

the registration statement—underwriters, directors of the corporation, accountants, engineers, and appraisers who have with their consent been named as having prepared or certified any part of the registration statement. The liability of the above-mentioned persons is not absolute but is subject to certain qualifications which are mentioned in the act.[35]

The Securities and Exchange Commission may make rules and regulations to carry out the provisions of the act. The commission may also ask for an injunction or writ of mandamus to compel compliance with the law.[36] A fine not to exceed $5,000, imprisonment up to five years, or both may be imposed upon a person who willfully violates the act.[37]

The Securities Act of 1933 does not in any way place a governmental guarantee behind the issues of stocks and bonds which are registered with the Securities and Exchange Commission. The commission does not attempt to determine the question of whether or not a particular security is a good investment. In fact, a rule of the commission requires the following statement:

> There shall be on the front page of every prospectus, in conspicuous print, the following three paragraphs, with the first and third paragraphs in capital letters:
>
> THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION.
>
> The ________ Company has registered the securities by filing certain information with the Commission. The Commission has not passed on the merits of any securities registered with it.
>
> IT IS A CRIMINAL OFFENSE TO REPRESENT THAT THE COMMISSION HAS APPROVED THESE SECURITIES OR HAS MADE ANY FINDINGS THAT THE STATEMENTS IN THE PROSPECTUS OR THE REGISTRATION STATEMENT ARE CORRECT.[38]

The act tries to do only two things. In the first place, it attempts to prevent fraudulent and misleading statements concerning issues of stocks and bonds. In the second place, it

[35] U. S. Code, Title 15, Sec. 77k.

[36] U. S. Code, Title 15, Sec. 77t.

[37] U. S. Code, Title 15, Sec. 77x.

[38] General Rules and Regulations of the Securities and Exchange Commission under the Securities Act of 1933, Rule 825.

seeks to require persons who desire to issue securities to divulge all information which might possibly be of value and interest to the investing public.

III. Federal Regulation of Security Exchanges.

Prior to 1934 there was no governmental regulation of the buying and selling of stocks and bonds on the various security exchanges throughout the United States. Although Federal and state governments had enacted considerable legislation covering the issuance and sale of new stocks and bonds, none of them had adopted legislation governing operations on the stock markets. Obviously, if legislation controlling securities exchanges was to be effective, it had to be enacted by the Federal rather than the state governments. If New York had enacted legislation controlling the New York Stock Exchange or the New York Curb Exchange and the operators of these markets had objected to control, they might have moved to Boston, Philadelphia, Chicago, or some city located in a state which had not attempted to regulate. Only Federal legislation could prevent such migration unless all states took the highly improbable course of adopting uniform legislation.

In 1934 Congress passed the Securities Exchange Act regulating the various stock markets. Most of the control was given to the newly-created Securities and Exchange Commission, although some power was conferred upon the Federal Reserve Board.

Among other things, the Securities Exchange Act is noteworthy because of the latitude which it allows to the Securities and Exchange Commission for the exercise of administrative discretion. Instead of prescribing definite statutory regulations or limitations the act gives to the commission the power to make rules and regulations pertaining to numerous subjects mentioned in the act, the only limitation being that such rules and regulations must be necessary or appropriate in the public interest and for the protection of investors.

Congress was probably wise in conferring upon the Securities and Exchange Commission the power to make rules and regulations and in giving to it considerable latitude for the exercise of administrative discretion instead of attempting to control by definite statutory prescription. The operations on the stock markets are complicated and technical. Only persons with

intimate and detailed knowledge can make regulations which are desirable. Furthermore, the situation on these markets changes rapidly. Rules which are satisfactory for one day may not be satisfactory for another. Regulation, to be effective, must be readily adaptable to new situations. In addition, these security exchanges are themselves in a position to exercise a large measure of control over members operating through their facilities. If the commission can induce exchanges to adopt adequate self-regulation concerning certain matters and then help to enforce these regulations, such action may obviate the necessity for commission rules covering certain practices. In other words, the rule-making power of the commission may be used in part as a threat in order to force exchanges to adopt adequate self-regulation.

The cornerstone of Federal regulation is the requirement that all national securities exchanges must register. However, the commission may exempt certain exchanges from these registration requirements if, in its opinion, by reason of the limited volume of transactions it is not in the public interest or for the protection of investors to require registration. Any exchange may be registered by filing a statement containing an agreement to comply with and enforce on members any rules and regulations made under the act; a copy of its constitution, articles of information, and bylaws; and such data concerning its organization, rules of procedure, and membership as the commission may require. No registration is to be granted or to remain in force unless the rules of the exchange provide for the expulsion, suspension, or disciplining of members. It is unlawful for any broker, dealer, or exchange to use the mails or any instrumentality of interstate commerce to effect any transaction in a security or to report any such transaction unless the exchange is registered with the commission.[39] Twenty-two national securities exchanges were registered with the commission on June 30, 1937. On the same date the commission had granted exemption from registration to seven exchanges.[40] Every national securities

[39] U. S. Code, Title 15, Secs. 78e and 78f.

[40] See Annual Report of the Securities and Exchange Commission, 1937, p. 15. The following have been registered as national securities exchanges:

Baltimore Stock Exchange
Board of Trade of the City of Chicago

exchange and every member, broker, or dealer must keep such accounts and papers as the commission prescribes.

The Securities Exchange Act not only requires the registration of securities exchanges but also requires the registration of all securities which are traded on these markets. It is unlawful for any member, broker, or dealer to trade in any security on a national securities exchange unless such security is registered in accordance with the provisions of the act. A security may be registered on a national exchange by filing an application with the exchange and giving the information required by the act. The exchange authorities are to certify to the commission that the security has been approved.[41]

One of the objects of the Securities Exchange Act is to give the investor information regarding the companies whose securi-

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Boston Stock Exchange
Chicago Curb Exchange
Chicago Stock Exchange
Cincinnati Stock Exchange
Cleveland Stock Exchange
Detroit Stock Exchange
Los Angeles Stock Exchange
New Orleans Stock Exchange
New York Curb Exchange
New York Real Estate Securities Exchange
New York Stock Exchange
Philadelphia Stock Exchange
Pittsburgh Stock Exchange
St. Louis Stock Exchange
Salt Lake Stock Exchange
San Francisco Curb Exchange
San Francisco Mining Exchange
San Francisco Stock Exchange
Standard Stock Exchange of Spokane
Washington (D. C.) Stock Exchange

The following exchanges have been granted exemption from registration:

Colorado Springs Stock Exchange
Honolulu Stock Exchange
Milwaukee Grain and Stock Exchange
Minneapolis-St. Paul Stock Exchange
Richmond Stock Exchange
Seattle Stock Exchange
Wheeling Stock Exchange

[41] U. S. Code, Title 15, Sec. 78 (l).

ties are listed on national exchanges. For purposes of registration many forms have been adopted requiring nonfinancial as well as financial information concerning the company whose stock is being registered.[42] After the initial registration of a security the company is required to file *interim* reports designed to bring up to date the information contained in the application for registration.[43] Although the act requires that all securities be registered, it does not require all securities to be listed on the stock exchanges. Considerable trading takes place in so-called unlisted securities.[44]

Obviously not all stocks are purchased through persons dealing on the various securities exchanges. Transactions conducted outside the exchanges are commonly referred to as "over-the-counter" sales.[45] The Securities Exchange Act provides for registration of persons who deal in "over-the-counter" transactions by requiring all brokers and dealers who use the mails or interstate commerce to induce the purchase or sale of securities otherwise than on a national securities exchange to register by filing with the commission an application containing such information as the rules of the commission require. The act also provides that any association of brokers or dealers may be registered with the commission as a national securities association. In order to be eligible for registration, the association must provide for self-regulation in accordance with the provisions of the act.[46] The above-mentioned provisions, which were amendments to the Securities Exchange Act of 1934, are designed to give the commission some information and provide for some control, largely self-regulation, for "over-the-counter" transactions.

The Securities Exchange Act contains certain provisions which are designed to control the use of *margins* in the purchase and sale of securities. The object of these provisions is to curb

[42] Rules and Regulations under the Securities Exchange Act of 1934, p. 151, Rule JB1.

[43] See Annual Report of the Securities and Exchange Commission, 1937, p. 16.

[44] See Report on Trading in Unlisted Securities upon Exchanges, prepared by the Securities and Exchange Commission, 1936, Government Printing Office.

[45] "Stock Market Control," Twentieth Century Fund Incorporated, p. 19.

[46] Public Act No. 621, 74th Congress, 2d Session, approved May 27, 1936; Public Act No. 719, 75th Congress, approved June 25, 1938.

speculation by preventing the excessive use of credit for the purchase or carrying of securities. The Federal Reserve Board has been given the power to prescribe rules and regulations with respect to the amount of credit which may be initially extended and subsequently maintained on any security registered on a national securities exchange.[47] The Federal Reserve Board has varied its margin requirements from time to time, depending upon whether it has wished to encourage or discourage market activity. In October, 1937, the board adopted a rule fixing the margin requirement at 40 per cent of the price of a security.[48] In other words, the prospective purchaser must pay to his broker in cash 40 per cent of the purchase price of the stock which he wishes to buy. Prior to this, the margin requirements had been somewhat higher.

The Securities Exchange Act places certain restrictions on borrowing by members, brokers, and dealers. It is unlawful for any member of a national securities exchange or any broker or dealer who transacts business through the medium of such member to borrow in the ordinary course of business on any security registered on a national securities exchange except through a member bank of the Federal Reserve System or through a nonmember bank which has an agreement to comply with the Federal Reserve Act. It is unlawful for a member, dealer, or broker to permit his aggregate indebtedness to all persons to exceed such percentage of his net capital employed in the business as the commission may prescribe. It is also unlawful for members, dealers, or brokers to pledge contrary to the rules of the commission any securities carried for the account of a customer which results in the commingling of the customer's securities with those of other persons. Finally, it is unlawful for a member, dealer, or broker to lend securities carried for the account of a customer without his written consent.[49]

One of the principal purposes in the passage of the Securities Exchange Act was to prohibit the manipulation of security prices by pools and individuals who wished to enrich themselves at the expense of the investing public. As might be expected, the act contains several provisions which are designed to achieve

[47] U. S. Code, Title 15, Sec. 78g.

[48] See *New York Times*, Oct. 28, 1937, p. 11.

[49] U. S. Code, Title 15, Sec. 78h.

this purpose. Some of the prohibitions are absolute, but others are forbidden only if they are contrary to the rules and regulations of the Securities and Exchange Commission. The practices which are absolutely forbidden are those that are unjustified under any circumstances. As might be expected, it is unlawful to circulate false and misleading information in order to induce persons to buy or sell securities. It is also unlawful to effect a series of transactions creating actual or apparent active trading in securities or raising or depressing the price of securities for the purpose of inducing purchase or sale. Likewise, it is unlawful for any person for the purpose of creating a false appearance of active trading of a security to effect any transaction in a security which involves no change in the beneficial ownership or to enter an order for the purchase or sale of securities with the knowledge that an order of the same size, at the same time, and at the same price has been entered by or for the same or different parties.[50]

As has been previously stated, certain manipulative devices, which sometimes have a legitimate use, are not absolutely prohibited but may be exercised in accordance with the rules of the commission. Contrary to the rules and regulations of the commission, it is unlawful to peg, fix, or stabilize the price of securities; to carry on certain transactions in connection with "puts," "calls," "straddles," and "options"; to effect a "short sale" or employ a "stop-loss" order;[51] or to employ any manipulative device.[52] Finally, the commission may prescribe rules and

[50] U. S. Code, Title 15, Secs. 78i and 78j.

[51] "A highly speculative type of stock exchange operation is option trading in its specialized forms of puts, calls, and straddles. An option is the privilege given, for a consideration, to the buyer (holder) by the seller (maker), usually a brokerage house, to demand the fulfilment of a purchase or sale contract for a certain amount of a certain security at a stipulated price on any day within a specified time limit. When the option is a put, the maker of the option is obligated, for the consideration paid by the purchaser, to receive from the latter a stated number of units of the security at a specified price within the stipulated time at the option of the holder. The call is just the reverse of the put, as it obligates the maker to deliver the security at the wish of the buyer. The straddle is a combination of put and call, binding the maker to accept and to deliver the same number of units of a certain security at the same price within the same period of time at the option of the holder." *Encyclopaedia of the Social Sciences*, Vol. XIV, p. 400. See also "Puts and Calls," bulletin prepared by Put and Call Brokers Association, Inc.

[52] U. S. Code, Title 15, Sec. 78i.

regulations to control and prevent trading by members of national security exchanges for their accounts.[53]

The Securities and Exchange Commission has been given some drastic powers to enforce the provisions of the act. After notice and opportunity for hearing, the commission may suspend or withdraw the registration of a national securities exchange, may withdraw the registration of a security, or suspend any officer or member of an exchange for violation of the act or any rules made thereunder.[54]

Under certain circumstances, the commission may suspend operations on securities exchanges when there has been no violation of the act or its rules and regulations. If, in its opinion, the public interest so requires, the commission may summarily suspend trading in any registered security for a period of ten days or less. With the approval of the president of the United States, the commission may suspend all trading on a national securities exchange for a period of 90 days or less.[55]

Persons aggrieved by orders of the commission may obtain a review in a circuit court of appeals.[56]

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[53] U. S. Code, Title 15, Sec. 78k.

[54] U. S. Code, Title 15, Sec. 78s.

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CHAPTER XIX

FEDERAL AND STATE CONTROL OF FOODS AND DRUGS

The changes which have taken place in the quality of the food supply of the United States since 1906 are numerous and far-reaching. It was estimated in 1890 that from $90,000,000 to $125,000,000 worth of food consumed annually in this country was adulterated or misbranded. Even though this was but 2 to 5 per cent of the total food supply of the United States, it was a large bill to pay for adulterated or misbranded foods.[1]

Some of the frauds which were foisted upon an unsuspecting public before the act of 1906 are interesting. Although the great bulk of the adulterated foods were harmless, there were a few products which were decidedly detrimental and in some cases even poisonous. Milk and butter were often preserved with a solution called "freezine" which contained a large percentage of formaldehyde. It was common to use copper to give a proper green color to pickles. Cayenne pepper contained a mixture of red lead and rice. The coloring materials for candies, notably coal-tar dyes, were sometimes poisonous.

By far the greater number of adulterated products on the market were fraudulent rather than harmful. Their injury consisted either in depriving persons of certain nourishment which they expected from the real product or in giving cheap substitutes to persons who had paid for genuine articles. Many of the adulterations were quite obvious, but others were ingenious and astonishing. What passed for olive oil was usually a cottonseed product. Cider vinegars were often made without a drop of apple juice. Apple sauce was made from pumpkin pulp with a dash of cider to give an apple flavor. A combination of molasses and flour was pressed into beans of the proper shape and size which when polished were sold for coffee. It has been stated that in 1903 there were six companies which were engaged in

[1] See "A Popular Treatise on the Extent and Character of Food Adulterations" by Alex. J. Wedderburn, *Bulletin* No. 25 of the Division of Chemistry, U. S. Department of Agriculture, 1890, p. 9.

manufacturing coffee-bean machines. Glucose was sold extensively for maple syrup or for strained honey. In fact, glucose with a dash of color, flavor, and a few timothy seeds sometimes served for strawberry jam. Spices were badly adulterated. For example, hulls and peas formed the basis for ginger; while charcoal, cracker dust, and spent cloves were made into allspice.[2]

In the crusade against impurities and adulterations the name of Dr. Harvey W. Wiley, who was for a long time chief of the Bureau of Chemistry, was almost synonymous with the phrase "pure foods and drugs." He was responsible for much of the investigation and many of the exposures which ultimately aroused public opinion. From the time of his appointment to the bureau in 1883 until the passage of the act in 1906 he was engaged in purifying the food supply of the United States. In 1902 he organized his famous "poison squad" which was composed of men from his bureau who agreed to eat only what he fed them.[3] Doctor Wiley was eager to test the effects of certain ingredients which manufacturers contended were harmless. His experiments caught the public fancy and doubtless had much to do with crystallizing public opinion to the point necessary to bring about legislation. Finally, in 1906, Congress passed the Pure Food and Drug Act. About the same time Congress enacted meat-inspection legislation which was designed to protect the public against conditions which had been revealed in the meat-packing industry.

Some state laws antedated the Federal Pure Food and Drug Act, but most of them were enacted after 1906. State pure food and drug laws were necessary to protect the public against impure foods and drugs which did not move in interstate or foreign commerce.

On the whole, the quality of the food supply of the United States improved materially after 1906, partly owing to state

[2] See "Foods and Their Adulteration" by Harvey W. Wiley. See also "A Popular Treatise on the Extent and Character of Food Adulterations" by Alex. J. Wedderburn, *Bulletin* No. 25, 1890, the Division of Chemistry, U. S. Department of Agriculture. See also "Some Food Products and Food Adulterations" by E. F. Ladd, *Bulletin* No. 57, 1903, North Dakota Agricultural College. For popular articles on the subject see 21 *Review of Reviews* 67, 7 *World's Work* 4377, 58 *Independent* 28.

[3] For a brief description of the work of the "poison squad," see "An Autobiography" by Harvey W. Wiley, pp. 215–220.

and Federal legislation and partly because of a realization on the part of manufacturers of food products that pure foods paid big dividends.

Despite the improvement in the quality of the food and drug supply of the United States after 1906, charges were made that the law was unsatisfactory in several respects.[4] For one thing, the act of 1906 did not cover false or misleading statements made in newspapers, over the radio, or through other advertising mediums. Advertisers were inclined to make extravagant claims for their products, but they could not be held accountable for misrepresentations under the Pure Food and Drug Act. Furthermore, the act did not cover cosmetics. Before 1938 many cosmetics were sold which were injurious to the health of persons who used them. Nor did the act of 1906 cover mechanical devices which were intended for curative purposes. Some of these devices, such as radium belts, were found to be harmful to those who had used them, yet because of statutory limitations the Food and Drug Administration was unable to take action against those who were furnishing these devices.[5]

In addition, the penalties for violation of the act of 1906 were so light and inconsequential that they did not serve as an effective deterrent. Many persons violated the law deliberately and paid the fine, regarding the penalty as a kind of fee which they paid to carry on business contrary to the provisions of the Pure Food and Drug Act. One of the great weaknesses of the act arose from the fact that in some cases which involved the prosecution of manufacturers of drugs the government was required to prove fraudulent intent in order to secure conviction.[6] Because fraudulent intent was often difficult to prove, many persons escaped who should probably have been convicted under the Pure Food and Drug Act.

In 1938 Congress enacted a new law entitled the Federal Food, Drug, and Cosmetic Act, which corrected many of the weaknesses of the Act of 1906. Also in 1938 Congress amended the Federal Trade Commission Act by providing that false and misleading advertising of foods, drugs, devices, or cosmetics is an unfair or

[4] "100,000,000 Guinea Pigs" by A. Kallet and F. J. Schlink.

[5] "100,000,000 Guinea Pigs" by A. Kallet and F. J. Schlink, p. 161.

[6] See Annual Report of the Chief of the Food and Drug Administration, 1933, p. 11.

deceptive practice within the meaning of Section 5 of the Federal Trade Commission Act.[7]

I. Federal Control under the Food, Drug, and Cosmetic Act.

Basically the Federal Food, Drug, and Cosmetic Act of 1938 is similar to the Act of 1906. It prohibits the introduction into or the receipt in interstate commerce of any food, drug, device, or cosmetic which is adulterated or misbranded. The act also prohibits the alteration, mutilation, destruction, or removal of any label while such article is held for sale after shipment in interstate commerce. In addition, the act contains the somewhat ambiguous statement that the adulteration or misbranding of any food, drug, device, or cosmetic in interstate commerce is prohibited.[8] This last statement probably refers to misbranding or adulteration which takes place during the transportation of the goods.

The act contains definitions of the various terms used in the above-mentioned section, adulterated and misbranded foods, drugs, devices, and cosmetics. In general, adulterated products are poisonous or harmful; whereas misbranded goods are merely deceptive or misleading.

The word *food* as used in the act refers to any food or drink which is used by man or animals.[9] A food is *adulterated* if it contains any poisonous, harmful, filthy, or decomposed substance. Likewise, it is adulterated if any valuable constituent has been omitted, any substance has been substituted, anything has been mixed so as to increase its bulk or weight, or anything has been done to conceal its inferiority. It must not have been prepared under insanitary conditions. It must not contain any coal-tar color except as permitted in the act. If it is a confectionery, it must not contain any alcohol or nonnutritive substance except harmless coloring or flavoring.[10] A food is *misbranded* if its label is misleading, if it is offered for sale under the name of another food, or if it is an imitation of another food. Likewise, it is misbranded if its container is so made or filled as to be mis-

[7] Public Act No. 447, 75th Congress, 3d Session.

[8] Public Act No. 717, 75th Congress, 3d Session, Sec. 301.

[9] Public Act No. 717, 75th Congress, 3d Session, Sec. 201(f). This definition of food includes chewing gum.

[10] Public Act No. 717, 75th Congress, 3d Session, Sec. 402.

leading. If it is in package form, the package must bear a label containing the name and place of business of the manufacturer or distributor and an accurate statement of the weight, measure, or numerical count. All information required by the act must be prominently displayed on the label so that it can be understood by an ordinary individual. If a food is represented as a food for which a standard has been prescribed under the act, it must conform to that standard. Finally, any food which contains a preservative or an artificial color must bear a label stating that fact.[11]

The word *drug* as used in the Pure Food, Drug, and Cosmetic Act includes any article recognized in the United States Pharmacopoeia or the National Formulary, any article which is intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in man or animals, or any article which is intended to affect the structure or functions of the body. The act defines the term *device* as any device intended for use in the diagnosis, cure, treatment, or prevention of disease in man or animals.[12]

A drug or device is *adulterated* if it is represented as one which is recognized in some official publication and its strength, quality, or purity falls below that standard or if it falls below any standard which is represented. The drug or device must not contain any filthy or decomposed substance or be prepared under insanitary conditions. Likewise, its container must not be composed of any poisonous or harmful substance.[13] The definition of a *misbranded* drug or device is somewhat similar to the definition of a misbranded food. The label must not be false or misleading; it must give the name and place of business of the manufacturer; and it must give an accurate statement of the contents in terms of weight, measure, or numerical count. If a drug contains any narcotic or habit-forming substance, the label must indicate the quantity and contain the statement, "Warning—May be habit-forming." The label must bear adequate directions for use of the drug or device. All of this information must be prominently displayed on the label so that it can be understood by the ordinary individual. If the drug is recognized in one of the official

[11] Public Act No. 717, 75th Congress, 3d Session, Sec. 403.
[12] Public Act No. 717, 75th Congress, 3d Session, Sec. 201.
[13] Public Act No. 717, 75th Congress, 3d Session, Sec. 501.

drug publications, it must be labeled and packaged as prescribed therein. The package or container must not be formed or filled so as to be misleading.[14]

The Pure Food and Drug Act of 1906 contained provisions pertaining to foods and drugs but did not provide any regulations of cosmetics. The Act of 1938, however, places cosmetics under the jurisdiction of the Food and Drug Administration. The act defines a *cosmetic* as any article except soap which is intended to be rubbed, poured, sprinkled, or applied to the human body for cleansing, beautifying, or altering its appearance.[15] A cosmetic is *adulterated* if it contains any poisonous, harmful, filthy, or decomposed substance, if it has been prepared under insanitary conditions, if its container is composed of any harmful substance, or if it contains coal-tar colors (except in the case of hair dye).[16] A cosmetic is *misbranded* if its label is false or misleading, if any statement required in the act is not prominently placed on the label, if it does not bear a label containing the name and place of business of the manufacturer and an accurate statement of the contents in terms of weight, measure, or numerical count, and if its container is made or filled so as to be misleading.[17]

The act also contains two other interesting and important provisions. The secretary of agriculture is given the authority to establish standards of identity or quality for any food whenever in his judgment such action will promote honesty and fair dealing in the interest of consumers.[18] Also, no person may introduce or deliver for introduction into interstate commerce any new drug without filing an application with the secretary of agriculture. The application must contain full reports of investigations which have been made to show whether or not such drug is safe for use, a list of articles which are used as components of the drug, a description of the methods of manufacturing and packing the drug, samples of the drug, and the labeling of the drug. The application is to become effective 60 days after filing unless the secretary of agriculture postpones the date because the results of tests show that the drug is unsafe for use or that the

[14] Public Act No. 717, 75th Congress, 3d Session, Sec. 502.
[15] Public Act No. 717, 75th Congress, 3d Session, Sec. 201.
[16] Public Act No. 717, 75th Congress, 3d Session, Sec. 601.
[17] Public Act No. 717, 75th Congress, 3d Session, Sec. 602.
[18] Public Act No. 717, 75th Congress, 3d Session, Sec. 401.

manufacturing or packing is inadequate to preserve the strength, quality, or purity of the drug.[19]

The enforcement of the Pure Food and Drug Act rests in part with the Food and Drug Administration of the Department of Agriculture and in part with United States district attorneys. Much of the time of the Food and Drug Administration is taken up with the examination of foods and drugs to determine whether or not they are adulterated or misbranded.[20] In attempting to carry out the provisions of the act, the Food and Drug Administration has taken the attitude that there are many ways to secure successful enforcement besides discovering and prosecuting violations. In the first place, the administration has conducted nation-wide "read the label" campaigns urging the public to scrutinize more carefully the labels of goods which it buys and to rely upon the labels for information concerning the content and effect of products.[21] In the second place, believing that only a comparatively small number of industries violates the act deliberately, the Food and Drug Administration has adopted the attitude that the act is corrective rather than punitive. Acting on this belief, it has undertaken to advise and suggest changes in adulterated products which will keep them within the law. Although the Food and Drug Administration has accomplished much by advertising, it has by no means eliminated the necessity for prosecutions. For the year ending June, 1936, more than 2,600 prosecutions and seizures were brought under the act.[22]

If legal action is necessary, the secretary of agriculture notifies the parties who are alleged to have violated the act and gives them an opportunity for a hearing. If it appears that a party has violated the provisions of the act, the secretary of agriculture certifies the facts to the proper United States district attorney.[23]

The act provides a criminal penalty for violation of its provisions. The guilty party is liable to a fine of not more than $1,000 or a year or less of imprisonment, or both. A fine of not more than $10,000, three years of imprisonment, or both is provided in case of violation with intent to defraud or mislead.[24]

[19] Public Act No. 717, 75th Congress, 3d Session, Sec. 505.

[20] Public Act No. 717, 75th Congress, 3d Session, Sec. 702.

[21] See *U. S. Daily*, Dec. 30, 1930, p. 1.

[22] Annual Report of the Chief of the Food and Drug Administration, 1936, p. 1.

[23] Public Act No. 717, 75th Congress, 3d Session, Sec. 305.

[24] Public Act No. 717, 75th Congress, 3d Session, Sec. 303.

In addition to the criminal provisions, the act states that any food, drug, device, or cosmetic which is adulterated or misbranded when introduced into or while in interstate commerce may be proceeded against while in interstate commerce or at any time thereafter by a process of libel in any district court of the United States and may be seized and condemned. If it is found to be misbranded or adulterated, such product may be either destroyed or sold, as the court directs. In this latter case the proceeds from the sale go to the Treasury of the United States. It is possible for the owner to secure the return of the goods which have been seized on payment of the costs of libel proceedings and the giving of a promise not to sell the goods contrary to the provisions of state and Federal laws.[25] It should be noted that this provision of the Act of 1938 permits the Federal authorities to make seizures not only during the interstate transportation of goods but at any time thereafter.

The constitutionality of a similar but less drastic provision contained in the Pure Food and Drug Act of 1906 was challenged but upheld in the case of *Hipolite Egg Company v. United States.* In that case, eggs which had been transported in interstate commerce and stored in a bakery were seized by Federal officers. The defendants contended that Congress had exceeded its commerce power in providing for the seizure of articles which had passed out of interstate commerce and had come under the jurisdiction of the states. They further contended that the articles had become mixed with the general property of the state and had therefore passed beyond the jurisdiction of the United States. In upholding the constitutionality of the act the Supreme Court pointed out, however, that while such a contention might have some basis when applied to legitimate articles of commerce, it was not valid when applied to such articles as adulterated or misbranded foods and drugs.[26]

II. Federal Control of Foods under Other Acts.

The Federal government has enacted a number of other statutes regulating food products. Among the most important of these are the so-called Meat Inspection Acts. Under these

[25] Public Act No. 717, 75th Congress, 3d Session, Sec. 304.

[26] Hipolite Egg Co. v. U. S. (1911), 220 U. S. 45, 55 L. Ed. 364, 31 S. Ct. 364.

the Department of Agriculture makes several kinds of inspection designed to prevent the distribution of tainted meat or meat products to the people of the United States.

The secretary of agriculture is to cause the inspection of all meat and food products prepared for interstate or foreign commerce in any slaughtering, meat-canning, salting, packing, or rendering establishment. Inspection is to be made also of all carcasses and parts of all cattle, sheep, goats, or swine which are to be prepared for human consumption in any of the plants mentioned above. Inspectors are to mark all products and carcasses found to be healthful and wholesome "inspected and passed" and to mark those which are unhealthful and unwholesome "inspected and condemned." Goods which have been condemned are to be destroyed. The secretary of agriculture is to cause the inspection of all slaughtering, meat canning, salting, packing, and rendering plants where cattle, swine, sheep, or goats are prepared for interstate or foreign commerce. If conditions are found to be insanitary or unwholesome, the inspecting authorities are to refuse to allow the products to be stamped "inspected and passed." Inspection is to be made also of all livestock which is to be slaughtered and prepared in such plants for shipment in interstate or foreign commerce.[27]

The inspection of meats and animals under the above provisions has been delegated to the Bureau of Animal Industry in the Department of Agriculture.[28]

Two other acts designed to improve the quality of the food supply of the United States should be mentioned. The Food and Drug Administration aids in the enforcement of the Federal Tea Act, which prohibits the importation into the United States of tea which fails to meet certain standards of quality set by the government.[29] The administration is charged also with the enforcement of the Federal Import Milk Act which requires

[27] U. S. Code, Title 21, Secs. 71–89.

[28] See Annual Report of the Chief of the Bureau of Animal Industry, 1930, p. 39.

[29] U. S. Code, Title 21, Sec. 41. See Service Monograph of the U. S. Govt., No. 50, p. 50, published by the Institute for Government Research. See also Annual Report of the Chief of the Food and Drug Administration, 1936, p. 22.

that foreign milk and cream shall meet certain standards of quality and purity.[30]

III. State Control of Foods and Drugs.

As might be expected, state laws on foods and drugs are numerous, are detailed, and present much variation. As a rule there is a law in each state which forbids the manufacture or sale of any food or drug which is adulterated or misbranded. Sometimes the definitions of the terms misbranded and adulterated and the prohibitions are very similar to those to be found in the Federal Food, Drug, and Cosmetic Act of 1938. For example, the Indiana statute defines the terms misbranded and adulterated in words very similar to those used in the Federal Food, Drug, and Cosmetic Act of 1938 and forbids the sale in intrastate commerce of any food, drug, device, or cosmetic that is adulterated or misbranded.[31]

The statutes of some states contain a number of provisions with regard to particular kinds of food. In Wisconsin the law declares that in all prosecutions relating to the manufacture or sale of misbranded or adulterated foods, certain standards and definitions are to be the legal standards and definitions. The law then sets high standards for a large number of food products. For example, meat must be from clean and healthy animals; canned fruit must be sterilized and hermetically sealed; dried fruit must be dried by a process so as to take nothing from its original state.[32] The Wisconsin act requires many products, such as olive oil, sugar, lemon extract, and flour to contain a definite percentage of certain ingredients which are mentioned in the act.[33]

The sale and production of milk products is the subject of much legislation and many rules and regulations. The concern which states manifest with regard to milk and milk products is due to two factors: (1) the extensive use of these products for children and invalids, and (2) the great susceptibility of milk to contamination. In order to protect dairy products, the state has taken

[30] U. S. Code, Title 21, Secs. 141–144. See also Annual Report of the Chief of the Food and Drug Administration, 1935, p. 23.

[31] Laws of Indiana, 1939, Chap. 38, Sec. 4.

[32] Wisconsin Statutes, 1937, Sec. 97.02.

[33] Wisconsin Statutes, 1937, Sec. 97.02.

many legislative precautions. Licensing of milk dealers is often required. Inspection of dairies, creameries, and similar places is provided for. Standards for butter, cheese, and milk are often fixed. It is unlawful to have insanitary utensils or insanitary conditions surrounding the manufacture and sale of milk and its by-products. No preservatives may be added to milk or dairy products.[34] In the case of *Nebbia v. New York* the Supreme Court pointed out the great number of laws in New York dealing with milk and dairy products.[35] Similar statutes are to be found in other states.

Various agents have been designated to administer pure food and drug laws in the different states. Sometimes a food and drug commissioner or a dairy and food commissioner has been placed in charge, and sometimes a state chemist or commissioner of agriculture has been designated as the chief administrative officer. The powers of these officials vary considerably. They are usually given authority to inspect various products. They are also given the power to inspect such places as bakeries, bottling works, groceries, public eating establishments, flour mills, slaughterhouses, and canning factories. Often they may bring criminal suits in court against persons who have violated the laws. Sometimes they may adopt and establish standards of quality, purity, and strength of articles of food and drink.[36] Usually they have authority to make rules and regulations to carry out the many provisions of the state food and drug acts.

If state control of foods and drugs is not effective, as a rule this ineffectiveness is not due to inadequate legislation. State legislation is usually adequate and comprehensive. However, legislative bodies have been slow to realize that adequate enforcement of the many food and drug laws requires a greater appropriation and a larger personnel than they have been willing to provide for. Adequate inspection of all places preparing or selling food, such as restaurants, roadside lunch stands, canning factories, and places which manufacture food products, would further public health, but it would require much more in men and money than the average commissioner or bureau of foods and drugs

[34] Cahill's Consolidated Laws of New York, 1930, Chap. 1, Secs. 46, 47, 54, 55, 57, 57a, 72–88, and 252. Wisconsin Statutes, 1937, Secs. 97.31 to 97.38.

[35] Nebbia v. New York (1934) 291 U. S. 502, 78 L. Ed. 940, 54 S. Ct. 505.

[36] Oregon Code of 1930, Title 41, Secs. 41-101 to 41-116.

has at its command. If, in addition to protecting health through such inspection, the bureaus or commissioners of foods and drugs are expected to prescribe standards or to prevent frauds in the sale of foods and drugs, legislative bodies should be more generous in the future than they have been in the past in making appropriations for the work of these divisions of state governments.

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CHAPTER XX

REGULATION OF BUSINESS THROUGH TAXATION

Although the taxing power is used by both Federal and state governments primarily to raise money in order that governmental services may be adequately performed, it has sometimes been employed as a regulatory medium. All taxes, of course, have some effect upon business. A high sales tax upon cigarettes will encourage persons to purchase cigars or pipe tobacco. Or a high tax upon the income of corporations will induce persons to operate business enterprises as individuals or partnerships. Likewise, exemptions from taxation may have a considerable effect upon business. The exemption of state and municipal bonds from the Federal income tax has induced large numbers of persons to invest in these securities and thereby has discouraged the investment of funds in private business. In other words, almost every tax or every exemption is bound to have economic consequences of importance to business.

However, we are not here concerned with taxes whose primary purpose is to raise revenue but which incidentally affect business, but we are concerned only with those taxes whose purpose is chiefly or in part at least to regulate.

I. Examples of Regulatory Statutes.

Many examples of the regulation of business through taxation can be found. Some of these regulatory statutes have been enacted by the states and many of them by the Federal government. For example, Congress has placed a tax of 10 per cent on the circulation and paying out of state bank notes.[1] It is perfectly evident that Congress has no intention of raising revenue by this act but has intended to drive state bank notes out of existence by making it highly unprofitable to issue and circulate such notes.

[1] U. S. Code, Title 12, Sec. 562.

Congress has imposed a tax of 10 cents a pound on all colored oleomargarine which is manufactured and sold. Manufacturers of oleomargarine are required to file such information, keep such records, post such signs, and conduct their businesses under such supervision as the commissioner of internal revenue may prescribe.[2] Obviously the government does not intend to raise revenue by this tax but wishes to prevent the sale of colored oleomargarine. This purpose is evident when one compares the heavy tax which is imposed upon colored oleomargarine with the much lighter tax of ¼ cent a pound which is levied on white oleomargarine.

Congress has dealt a death blow to the manufacture of phosphorus matches by taxing them at the rate of 2 cents per hundred. If persons manufacture such matches, they are required to observe certain regulations concerning manufacturing and packing.[3] Obviously no company is going to produce phosphorus matches with a tax of 2 cents per hundred when sulphur matches, which are better matches, can be manufactured and sold at 1 cent for a box of 36 matches without paying the tax.

Congress has imposed varying degrees of taxes upon persons who manufacture, sell, or deal in certain narcotic drugs, such as opium or the products of cocoa leaves. Importers, wholesale dealers, retail dealers, physicians, and dentists must register with the collector of internal revenue and pay taxes varying from $1 to $24 a year. The act makes it unlawful for any person who has not registered and paid the tax to have in his possession any of the forbidden narcotics.[4]

The Future Trading Act of 1921, which was later declared unconstitutional, imposed a tax of 20 cents a bushel on the sale of grain for future delivery but made exceptions for sales which took place upon boards of trade designated by the act as contract markets. Provisions were made for the licensing and the regulating to some extent of such markets by the secretary of agriculture.[5]

In 1919 Congress levied a tax of 10 per cent on the annual profits of any person engaged in mining, manufacturing, or

[2] U. S. Code, Title 26, Secs. 971–972.

[3] U. S. Code, Title 26, Secs. 1071–1073.

[4] U. S. Code, Title 26, Secs. 1383–1388.

[5] 42 Stat. L. 187.

quarrying who employed children under the age of fourteen. The amount of the tax was the same whether the employer employed 1 or 500 children during the year. The tax was not levied, however, if the employer did not know that the children were under the forbidden age.[6] This child labor act was declared unconstitutional by the Supreme Court of the United States.

One of the best-known attempts by Congress to make use of the taxing power for regulatory purposes was that undertaken in the Agricultural Adjustment Act of 1933. A tax was placed upon the processing of certain farm products, such as wheat, cotton, and livestock. The proceeds from these taxes were used to pay farmers who agreed to limit the production of these products.[7] The act was held to be invalid by the Supreme Court.

In 1935 Congress enacted the Bituminous Coal Conservation Act which imposed a tax of 15 per cent on the sale of coal at the mine. If any producer accepted the code for which the act provided and acted in compliance therewith, he was entitled to a drawback of 90 per cent of the amount of the tax.[8] This act was also declared unconstitutional.

Perhaps the outstanding illustration of a regulatory tax is that of the tariff. Although the tariff is intended in part to raise revenue, the Tariff Act frankly states at the beginning that it is designed to protect the industries of the United States from foreign competition. In addition to the statement at the beginning of the act, certain other features of the tariff clearly indicate its regulatory character. The combined specific and ad valorem duties on many products are so high that it appears certain that Congress intended to discourage imports of these commodities.[9] The duty is 150 per cent on straw hats, 140 per cent on "embroidered or embellished" leather, 90 per cent on dolls, and 135 per cent on firecrackers.[10] In contrast to the duties on these articles, one finds no tariff duties on such articles as shoe machinery, typesetting machines, and farm implements for which there is

[6] 41 Stat. L. 306.

[7] 48 Stat. L. 31.

[8] 49 Stat. L. 991.

[9] In the case of an ad valorem duty the rate is fixed according to value. In the case of a specific duty the rate is fixed at so much per pound, dozen, barrel, etc.

[10] "The Tariff History of the United States" by F. W. Taussig, 8th ed., 1931.

little competition from abroad or such articles as bananas and coffee for which there is no substitute in this country. In imposing high duties on some articles and in placing other articles on the free list Congress has obviously made use of the taxing power as a regulatory device.

Furthermore, the machinery which Congress has established for raising or lowering duties indicates that the tariff is in part regulatory in character. Congress of course fixes all duties in the first instance. However, one of the important tasks of the Tariff Commission is to investigate duties under the tariff with a view to equalizing costs of production between domestic and foreign articles. Such investigations are made on the request of the president of the United States or Congress, on motion of the commission, or on application of an interested party. If the duties fixed by statute do not equalize differences in cost of production between the domestic and foreign article, the commission is to propose in its report to the president increases, decreases, or changes in classification. The Tariff Act authorizes the president to increase, decrease, or to make changes in classification if such changes are necessary in order to equalize differences in costs of production. In no case may total increases or decreases exceed 50 per cent of the rates fixed by statute, nor may articles be transferred between dutiable and free lists.[11]

In 1937 Congress passed the Bituminous Coal Act. This act imposes a tax of 19½ per cent on the sale of coal at the mine. However, the sales of any producer who is a member of the code for which the act provides are exempt from the tax so long as he remains a member of the code.[12]

The undistributed profits tax which was enacted by Congress in 1936 furnishes another illustration of a tax which was at least partly regulatory in character.[13] Although this tax was passed in part to raise additional revenue for the Federal government, it was also a regulatory measure. It was intended to encourage the distribution of dividends and the payment of higher wages. It was designed also as a means of preventing the concentration

[11] U. S. Code, Title 19, Sec. 1336.

[12] Public Act No. 48, 75th Congress, 1st Session, approved Apr. 26, 1937, Sec. 3(b).

[13] See "The Undistributed Profits Tax" by Alfred G. Buehler, Chaps. III and X.

of too much control of industry in a few large corporations. The undistributed profits tax did not abolish the regular income tax on corporations but placed an additional tax on their undistributed net income. The undistributed net income was computed by subtracting from the net income the value of dividends paid out by corporations in cash or otherwise. The tax on undistributed profits ranged from 7 to 27 per cent. For example, a tax of 7 per cent was imposed upon the undistributed net income of a corporation which was not in excess of 10 per cent of the total net income, and a tax of 27 per cent was imposed upon the undistributed net income of a corporation which was in excess of 60 per cent of the total net income.[14] The provisions of this statute were later modified because of the tremendous opposition raised by large corporations which were desirous of setting aside a portion of their income for surplus.

From the above-mentioned examples, some idea can be gained of the extent of the use of the taxing power by the Federal government as a regulatory medium. Many persons have urged an even more extensive use and have made proposals for other regulatory tax measures. One of the most interesting of these was a proposal for the use of the taxing power as a device to encourage business to absorb the unemployed. According to this proposal, a tax exemption or credit would be given to any corporation which would increase its payrolls by a certain percentage. According to the advocates of this tax, if a company learned that instead of paying heavy taxes to the Federal government it could be credited with or exempt from the payment of taxes, it would probably reemploy a certain number of persons and thereby take some of the relief load from the Federal government.

Not only the Federal government but also the state governments have enacted tax laws which are regulatory in character. However, the use of the taxing power by the states as a regulatory medium has not been as common as its use by the Federal government for reasons which are discussed later.

Several states have taxed chain stores, not with the intention of raising revenue, but in order to handicap such stores and thereby to assist independent merchants. The state of Indiana

[14] Public Act No. 740, 74th Congress, 2d Session, approved June 22, 1936, Sec. 14.

has placed an annual tax of $3 per store upon persons who operate one store, $10 per store upon persons who operate 2 to 5 stores, $20 per store upon persons who operate 5 to 10 stores, $30 per store upon persons who operate 10 to 20 stores, and $150 per store upon persons who operate more than 20 stores.[15]

Some of the states have imposed a tax upon oleomargarine. A good illustration is that of Wisconsin, which has placed an occupational tax upon the sale or use of oleomargarine. No person may sell or serve oleomargarine to guests unless he obtains a license from the state. The tax for an annual license varies considerably, depending on the occupation of the licensee. A manufacturer pays $1,000; a wholesale dealer pays, $500; a retail dealer, $25; a proprietor of a restaurant, $25; and the proprietor of a boardinghouse, $5. Although the Wisconsin act states that the purpose of the law is to raise revenue, it is obviously designed as a curb upon the use of oleomargarine and is intended to encourage the use of dairy products in Wisconsin.[16]

Another illustration of a regulatory tax imposed by some of the states is the tax upon insurance companies. For example, the State of Iowa has endeavored to encourage the formation of domestic insurance corporations by placing a tax of 2½ per cent of the gross amount of premiums received by insurance companies incorporated under the laws of other states and imposing a tax of only 1 per cent upon the gross receipts from premiums of companies incorporated under the laws of the State of Iowa.[17]

Obviously the heavy taxes imposed by the various states upon the sale and manufacture of intoxicating liquors have a twofold purpose. They are designed of course as an important source of revenue, but they are intended also to discourage the use of intoxicating beverages.

One of the most recent examples of a state tax which is in part regulatory is the so-called "use tax" which has now been adopted by several of the states. In those states which have adopted this tax, 2 or 3 per cent is imposed upon the use, storage, or consumption of tangible personal property within the state. The measure of the tax is either the sale price or the purchase price of tangible personal property. The principal purpose

[15] Burn's Annotated Statutes of Indiana, Sec. 42-305.

[16] Wisconsin Statutes, 1937, Sec. 97.42.

[17] Code of Iowa, 1935, Secs. 7022 and 7025.

behind the enactment of the use tax has been the desire to extend protection to merchants whose sales are subject to a state sales tax against the competition of merchants in other states which do not have a sales tax and from the competition of merchants who are engaged in nontaxable interstate commerce.[18]

II. Types of Regulatory Statutes.

Although all of the above-mentioned statutes have been regulatory in character, not all of them have had the same *purpose* or used the same *technique* for achieving regulation.

Some taxes have obviously been designed to prohibit a certain thing or a certain course of conduct. The Federal tax on state bank notes is intended to destroy and has the effect of destroying obligations of this character. Likewise, the tax on phosphorus matches which has been levied by the Federal government is so heavy that companies have ceased to manufacture matches of this type.

Other taxing statutes have not been designed to destroy a business but merely to penalize and thereby equalize competition between persons engaged in that business. The taxes on chain stores enacted by many states are an illustration of a regulatory tax of this character. Indiana, for example, has not destroyed chain stores by its tax, but it has penalized chain stores and equalized somewhat the competition between such stores and independent stores. Likewise, under the Tariff Act, Congress has tended to equalize competition between American and foreign manufacturers. As has been previously pointed out, one of the chief purposes of the so-called "use tax" is to equalize competition between merchants in a state which has a sales tax and merchants in other states who ship into the state but who cannot be subjected to the state sales tax.

Still other taxing statutes have been intended, not to destroy a business, but merely to force persons to conduct the business in accordance with certain rules and regulations. The tax imposed by the Federal government upon grain futures was of this character. The Federal government did not wish to destroy the trading in grain futures but merely to force persons to buy

[18] For a discussion of the use tax, see "Report of the Proceedings of the 1937 Conference of the National Association of Tax Administrators," pp. 24–26.

and sell on boards of trade which were licensed and regulated by the government. Likewise, the heavy tax imposed by the Federal government upon the sale of bituminous coal was not intended to prevent the sale of coal but merely to force all mine owners to subscribe to the Coal Code and the regulations of the Bituminous Coal Commission.

Other taxes are designed to raise revenue and at the same time to discourage, but not prohibit, the use of certain products. Heavy taxes on liquor and oleomargarine are taxes which are obviously intended to achieve this twofold purpose.

Sometimes legislatures have imposed a tax which is designed to raise revenue and then have provided that the money derived from the tax shall be paid to certain persons in order to induce them to follow a particular course of conduct. In this case the taxing statute is a revenue-raising measure and the expenditure of the money is the regulatory medium. In other words, one group of persons is taxed but another group is regulated. The Agricultural Adjustment Act was of this character. The millers and meat packers were taxed, but the money derived from the tax was used to regulate the farmers in order to induce them to curtail the production of cotton, wheat, and other farm commodities.

III. Reasons for the Use of the Taxing Power to Regulate.

That the taxing power can be a potent regulatory medium is indicated by the maxim, "The power to tax is the power to destroy." On the whole, however, the taxing power is not a satisfactory regulatory device. To draw up effective legislation is not easy under the most satisfactory conditions. To mold a regulatory statute in the form of a revenue-raising measure presents certain additional problems in legislative technique.

The question then naturally arises as to why the government should employ a revenue-raising power as a regulatory device. There are several possible reasons for the use of the taxing power as a regulatory medium. For one thing, if the legislature intends to prohibit altogether, the use of the taxing power may be advantageous. To tax a thing or transaction out of existence instead of forbidding it and imposing criminal penalties may make the task of law enforcement somewhat easier. For another thing, if the government intends to raise revenue as well as to regulate

or if the government merely seeks to equalize competition but does not desire to prohibit a particular business, the use of the taxing power is logical.

The use of the taxing power as a regulative device is prompted chiefly, in the case of the Federal government, by the necessity of circumventing constitutional prohibitions. Congress is limited by the doctrine of the division of powers between Federal and state governments. Under the Constitution of the United States, Congress has been given delegated powers only and is therefore distinctly restricted in its regulatory power. The powers which might be construed as conferring upon Congress any regulatory authority over business are not numerous. The postal power, the commerce power, the power over patents and copyrights, the power over bankruptcy, and the taxing power are the only ones of importance. The powers pertaining to bankruptcy and patents and copyrights are obviously limited in their scope. Even the commerce power does not confer upon Congress unlimited authority to regulate business. Congress can regulate only interstate commerce or business closely related thereto.

On the other hand, the taxing power has seemed to Congress to offer regulatory possibilities which are nonexistent even under the commerce power. Congress can levy taxes to pay the public debt and to provide for the common defense and general welfare. Broadly interpreted, this would offer numerous possibilities for Federal regulation. The Supreme Court, however, on several occasions has not agreed with the interpretation which Congress has placed on this clause and has declared several regulatory taxing statutes unconstitutional.

It is by no means easy to determine from the decisions of the Supreme Court of the United States the constitutional limits of the taxing power. As has been previously pointed out, Congress may levy taxes to provide for the general welfare. This might be given a very broad interpretation and Congress might be allowed to pass regulatory taxing statutes whose sole purpose would be to control in the interests of the general welfare. But the Supreme Court has been unwilling to place so broad an interpretation upon these words of the "taxing clause." The case of *United States v. Butler* declaring the Agricultural Adjustment Act unconstitutional seems to indicate that Congress may spend

money for the general welfare but may not regulate by taxation for the general welfare.[19]

Obviously Congress can use the taxing power to regulate a business if it can control that business under some of its other delegated powers. Since Congress can control banking under its implied powers, Congress can constitutionally levy a tax on state bank notes.[20] Likewise, since Congress can control foreign and interstate commerce under its commerce power, there seems to be no constitutional objection to the use of the taxing power to regulate such commerce.[21] Perhaps the Bituminous Coal Act of 1937 is constitutional in spite of the use of the taxing power to regulate because Congress has merely made use of the taxing power to control a phase of interstate commerce. The preamble to this act states that the regulation of the sale and distribution in interstate commerce of bituminous coal is imperative in order to protect such commerce.

Apparently there is no constitutional objection to a Federal statute which regulates or prohibits if, on the face of it, the statute is a taxing measure and if the regulations are enforced through the regular taxing divisions of the Federal government.[22] The statutes taxing colored oleomargarine, narcotics, and phosphorus matches are essentially regulatory statutes, but on the surface, at least, they impose Federal taxes and their regulations are carried out by the Department of the Treasury. On the other hand, the Child Labor Law which imposed a 10 per cent tax on the annual profits of persons who employed children under a certain age was declared unconstitutional because the Federal government had imposed a penalty and not a tax. The child labor tax was levied only in case an employer knew that he was employing child labor. Likewise, it was imposed whether the employer employed one child or 500 children during the year. These provisions seemed to the Supreme Court of the United States to stamp the tax as a penalty, and the court held that Congress was given no power to levy penalties under the Constitution.[23] The Future Trading Act of 1921, the Agri-

[19] U. S. v. Butler (1936) 297 U. S. 1, 80 L. Ed. 477, 56 S. Ct. 312.

[20] Veazie Bank v. Fenno (1869) 5 Wall. 533, 19 L. Ed. 482.

[21] Hampton v. U. S. (1928) 276 U. S. 394, 72 L. Ed. 624, 48 S. Ct. 348.

[22] McCray v. U. S. (1904) 195 U. S. 27. 49 L. Ed. 78, 24 S. Ct. 769.

[23] Bailey v. Drexel Furniture Co. (1922) 259 U. S. 20, 66 L. Ed. 817, 42 S. Ct. 449.

cultural Adjustment Act of 1933, and the Coal Conservation Act of 1935 were declared unconstitutional because they were obviously not revenue measures but regulatory statutes.[24] Undoubtedly the fact that the regulations under these laws were enforceable, not by the Department of the Treasury, but by other divisions or departments of the government was cogent evidence to the court that they were not revenue measures.

The reasons for the use of taxing power by the states as a device for regulation are somewhat obscure. The states enjoy police power which enables them to protect the health, morals, safety, and general welfare of the public. Such broad power should enable them to legislate extensively and should obviate the necessity for use of the taxing power as a device for control. Yet one finds illustrations in state legislation of taxing measures which are chiefly regulatory statutes, where the use of the police power would seem to offer the logical medium.

There are several possible answers to this apparent anomaly. In the first place, it is possible that a state legislature may be forced to resort to the taxing power in order to stay within some limitations of the state constitution. In the second place, the legislature may feel that a taxing statute with a somewhat hidden regulatory purpose may find more favor with the courts than an obviously prohibitory or regulatory statute. In the third place, the state may desire to raise revenue and at the same regulate, and the use of the taxing power is obviously the logical medium for achieving this twofold purpose. In the fourth place, the use of the taxing power may provide a comparatively simple method of equalizing competition between certain kinds of businesses.

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[24] Hill v. Wallace (1922) 259 U. S. 44, 66 L. Ed. 822, 42 S. Ct. 453; U. S. v. Butler (1936) 297 U. S. 1, 80 L. Ed. 477, 56 S. Ct. 312; Carter v. Carter Coal Co. (1936) 298 U. S. 238, 80 L. Ed. 1160, 56 S. Ct. 855.

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CHAPTER XXI

ADMINISTRATION OF BANKRUPTCY

Commerce and industry cannot be carried on unless most persons abide by the contracts and obligations which they have undertaken. In general, the state should compel the fulfillment of contracts. Even Herbert Spencer, the exponent of extreme individualism, believed that the state should require persons to abide by their obligations. Under certain circumstances, however, legislators have found it expedient for economic or social reasons to provide some method of relieving persons from complete fulfillment of their obligations. Frequently persons are overwhelmed by financial disaster because of lack of foresight, through carelessness, or through no fault of their own. Under such circumstances, for the state to try to compel the complete fulfillment of obligations is futile and unjust. In times of depression and deflation it is unwise from an economic standpoint. As deflation proceeds, the burden of indebtedness increases and recovery becomes more difficult. Bankruptcy is a common device by which the state provides a method of escape for persons who through accident or lack of foresight find themselves in a hopeless financial condition.

Bankruptcy laws are advantageous not only to debtors but also to creditors. If creditors cannot be paid in full, obviously they desire some device to obtain as much as possible and to prevent the wasting of the debtors' assets. Bankruptcy statutes protect creditors against one another and against the debtor by providing for a prompt and impartial distribution of assets.

The Federal government has exclusive jurisdiction over bankruptcy. The question of whether or not the Federal government should be given the authority to regulate bankruptcy does not seem to have provided much discussion or controversy either during the convention or during the period of ratification of the Constitution of the United States. James Madison, writing in *The Federalist,* declares:

The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different states, that the expediency of it seems not likely to be drawn into question.[1]

Article I, Section 8, of the Constitution of the United States states, "The Congress shall have power . . . to establish . . . uniform laws on the subject of bankruptcies throughout the United States." In connection with this clause a few interesting constitutional questions have presented themselves for judicial consideration. One of the most important is the question of the power of the states to enact bankruptcy laws. Although the courts have not answered this question satisfactorily in all particulars, they have laid down a few general rules. In the first place, it is clear that if there is no Federal statute on the subject, the states have the power to pass bankruptcy laws of their own—subject of course to the constitutional limitation that such legislation shall not impair the obligation of contract.[2] The importance of this rule, that the states may regulate bankruptcy, becomes obvious when one realizes that during many rather extended periods of time the Federal government has had no bankruptcy legislation.

In the second place, the rule seems clearly established that a Federal law dealing with bankruptcy is paramount and that state statutes must yield in case of conflict. In the third place, it is generally held that state laws are not destroyed by the enactment of a Federal bankruptcy law but are merely suspended and presumably take effect upon a repeal of the Federal law. The question which has caused most difficulty is the question of whether state bankruptcy laws have been completely suspended by the passage of a Federal act or whether parts of such state laws pertaining to persons or matters not covered by the Federal act remain in force. In some jurisdictions it has been held that state laws are valid if they cover somewhat different grounds from those covered by the Federal act. The better rule appears to be, however, that the Federal Bankruptcy Act is intended to cover the entire field, and therefore state laws on

[1] *The Federalist*, No. XLII.
[2] Sturges v. Crowninshield (1819) 4 Wheat. 122, 4 L. Ed. 529.

bankruptcy have been completely suspended.[3] It should be noted, however, that states do have power to legislate on subjects somewhat related to bankruptcy, such as assignments for the benefit of creditors, receiverships, or collection of debts by other procedure than that of bankruptcy.

One more constitutional point is worthy of mention. Fortunately the courts have held that the term bankruptcy is not to be given the same limited meaning it had in English law at the time of the adoption of the Constitution.[4] To have followed the English rule would have imposed serious limitations upon this power of Congress.

In furtherance of its constitutional power to control bankruptcy Congress enacted a number of statutes, the first in 1800, another in 1841, and third in 1867. None of these acts remained in force for a long period of time.[5] Finally, in 1898, Congress enacted a fourth bankruptcy act. This act, which was drastically revised in 1938, is the basis for the Federal law on the subject today. In 1933, 1934, and 1938 Congress added provisions which permit certain debtors instead of going through regular bankruptcy proceedings to obtain relief from their indebtedness in other ways.

I. Regular Bankruptcy Procedure.

1. *Kinds of Bankruptcy and Persons Who May Become Bankrupt.* The Federal Bankruptcy Act recognizes two kinds of bankruptcy, voluntary and involuntary. Any person except a building and loan association or a railroad, insurance, banking,

[3] For a discussion of this point see the article, "The Effect of a National Bankruptcy Law upon State Laws" by Samuel Williston, 22 *Harvard Law Review* 547. In this article the author argues that Congress by the Act of 1898 shows an intent to cover the entire field and therefore state bankruptcy laws should be regarded as completely suspended. This view is supported by the writer of a note in 15 *Minnesota Law Review* 582. The language and decision of the Supreme Court in International Shoe Co. v. Pinkus (1929) 278 U. S. 261, 73 L. Ed. 318, 49 S. Ct. 108 seem to support this point of view.

[4] For a discussion of this see "The Constitutional Law of the United States" by W. W. Willoughby, p. 1096.

[5] See "A History of the Bankruptcy Clause of the Constitution of the United States of America" by F. Regis Noel.

or municipal corporation may take advantage of the provisions of the law for voluntary bankruptcy.[6]

In the case of involuntary bankruptcy a petition may be filed by three or more creditors who have provable claims which amount in the aggregate to at least $500, or by one or more creditors whose claims amount to at least $500 when there are fewer than twelve creditors.[7]

The law provides that any *natural* person owing $1,000 or more, except a wage earner or a farmer, may be adjudged an involuntary bankrupt.[8] The term "wage earner" as used in this part of the act includes any person who works for wages, salary, or hire at a rate of compensation which does not exceed $1,500 per annum.[9] The term "farmer" as used in the statute refers not only to one primarily engaged in tilling the soil, but also includes persons engaged in dairy farming or stock raising.[10]

Any partnership and any moneyed business or commercial corporation except a building and loan association or a municipal, railroad, insurance, or banking corporation may be adjudged an involuntary bankrupt. To be subject to such bankruptcy proceedings the corporation or company must have debts amounting to at least $1,000.[11] Apparently charitable, religious, or educational corporations are not subject to involuntary bankruptcy proceedings as they are not operated for a profit and cannot be considered moneyed or commercial enterprises.

Before a person can be adjudged an involuntary bankrupt, he must have committed one of the acts of bankruptcy enumerated in the statute. There are six acts any one of which, if committed by a debtor, will justify an adjudication in bankruptcy. The first consists of the conveyance, transfer, concealment, or removal of any part of the debtor's property with the intent to hinder, delay, or defraud the creditors. The second act of bankruptcy consists of the transfer while insolvent of any of the debtor's property to one or more creditors with the

[6] Public Act No. 696, 75th Congress, 3d Session, Sec. 4.
[7] Public Act No. 696, 75th Congress, 3d Session, Sec. 59.
[8] Public Act No. 696, 75th Congress, 3d Session, Sec. 4.
[9] Public Act No. 696, 75th Congress, 3d Session, Sec. 1(27).
[10] Public Act No. 696, 75th Congress, 3d Session, Sec. 1(17).
[11] Public Act No. 696, 75th Congress, 3d Session, Sec. 4.

intent to prefer such creditor or creditors. The third act of bankruptcy is permitting while insolvent any creditor to obtain a lien through legal proceedings which is not discharged or vacated within 30 days. The fourth act of bankruptcy consists of making a general assignment for the benefit of creditors. The fifth act of bankruptcy is permitting the appointment while insolvent of a trustee or receiver to take charge of the property. The sixth act of bankruptcy is admitting in writing an inability to pay debts and a willingness to be adjudged a bankrupt.[12]

The act provides for a very short and definite period of time within which to commence involuntary bankruptcy proceedings. A petition may be filed within four months after one of the acts of bankruptcy has been committed.

2. *Procedure in Bankruptcy Cases.* Bankruptcy cases are instituted and tried in the district courts of the United States. Each of the district courts gives considerable time to bankruptcy cases. In fact, if all the details of the many bankruptcy cases were handled by Federal judges, they would have little time to devote to other kinds of litigation. In order to relieve Federal judges of some of the burden, officials known as *referees* handle a large share of the detail and routine in bankruptcy cases.

In either voluntary or involuntary bankruptcy the proceedings are commenced by filing a petition in the proper Federal court. The petition must be drawn according to a prescribed form and must allege among other things the facts which are necessary to warrant an adjudication in bankruptcy on the part of the court. A summary of the debts and assets of the debtor is drawn up and annexed to the petition.[13]

At this stage in the proceedings a few words should be said concerning *receivers.* A receiver is an officer appointed by the court to take charge of the estate. Although receivers are not appointed in all bankruptcy cases, it is usual to petition for their appointment if a bankrupt is engaged in a business which should be continued to prevent a loss of assets. The act provides that a bankruptcy court may upon application of the parties in interest appoint a receiver to take charge of the property of the bankrupt until the petition in bankruptcy is either

[12] Public Act No. 696, 75th Congress, 3d Session, Sec. 3.

[13] For Bankruptcy Forms and Bankruptcy Orders see Mason's U. S. Code Annotated, Supplement No. 2, pp. 153–184.

dismissed or a trustee is appointed and qualified to take charge of the estate.[14]

After the papers have been filed and served, the next step is to determine whether or not the party should be adjudged a bankrupt. Any person against whom an involuntary petition has been filed is entitled to have a trial by jury to determine the question of his solvency or insolvency. In most cases there is no contest, however, and the judge after the expiration of the time for filing pleadings makes an adjudication either declaring the party a bankrupt or dismissing the petition.[15]

After the adjudication in bankruptcy the case is turned over to a referee, who acts in lieu of the judge in most of the subsequent proceedings. Because of the great number of bankruptcy cases it is often necessary to appoint several referees for one judicial district. The jurisdiction and duties of referees are extensive. They have jurisdiction to consider petitions and make adjudications in bankruptcy or dismiss petitions. They may take possession of or lease the property of a bankrupt. They may grant, revoke, or deny discharges.[16] The Bankruptcy Act prescribes a number of duties which referees are obliged to perform. One of the important duties of a referee is to give proper notices to creditors of the various steps in bankruptcy proceedings. Notices must be given of the examination of a bankrupt, of hearings upon application for the confirmation of arrangements or wage earners' plans, of creditors' meetings, of proposed sales of property, of compromises, and of the filing of accounts.[17] Another important duty of a referee is to examine the bankrupt's schedule. The bankrupt is required to file a schedule of his property and a list of his creditors together with the claims and the security which each holds. Other duties of a referee are to keep and transmit to the court proper records of proceedings and to declare dividends from the assets of the bankrupt's estate.[18]

After the adjudication in bankruptcy the court is required to call a meeting of the creditors. Upon the receipt of a notice

[14] Public Act No. 696, 75th Congress, 3d Session, Sec. 2(3).

[15] Public Act No. 696, 75th Congress, 3d Session, Sec. 19.

[16] Public Act No. 696, 75th Congress, 3d Session, Sec. 38.

[17] Public Act No. 696, 75th Congress, 3d Session, Sec. 58.

[18] The Bankruptcy Act enumerates in detail the duties of a referee. See Public Act No. 696, 75th Congress, 3d Session, Sec. 39.

of such meeting the creditors file their claims. The purpose of this first meeting over which the referee usually presides is to allow the claims that have been filed by creditors, to examine the bankrupt, and to elect a trustee.[19]

According to the statute a *trustee* is to be elected by the creditors at their first meeting but, if they do not make a selection, he may be appointed by the court. The duties of a trustee are enumerated in the Bankruptcy Act. In general, the trustee is the representative of the creditors. He is to collect and to reduce to money the property of the bankrupt and to close up the estate as quickly as is compatible with the best interests of the parties concerned; he is to account for and pay over to the estate all interest received on behalf of the estate; he must deposit all money received in one of the designated depositories; he must keep and file regular accounts; he must furnish certain information on request; he must pay the dividends which have been declared by the referee; and he must set apart the bankrupt's exemptions and report the value thereof to the court as soon as practicable.[20]

A few words should be said concerning some of the duties of the trustee mentioned in the preceding paragraph. An adjudication in bankruptcy and the appointment of a trustee divests the bankrupt of the right of possession and the title to his property. Upon the appointment of a trustee the title and the right of possession are vested by operation of law in the trustee as of the date of bankruptcy.[21] It is possible, therefore, for the trustee to sell and convey title of the bankrupt's property to a purchaser. The act provides that, whenever practicable, real and personal property is to be sold subject to the approval of the court, but in no case can it be sold for less than 75 per cent of its appraised value without the approval of the court.[22]

It is to be noted that certain transfers of the property of the bankrupt which have taken place within four months prior to

[19] For brief descriptions of bankruptcy procedure, see "Credits and Collections in Theory and Practice" by Theodore N. Beckman, Chap. XXVI; and "The Law of Bankruptcy" by Charles W. Gerstenberg.

[20] Public Act No. 696, 75th Congress, 3d Session, Secs. 44 and 47.

[21] "A Treatise on the Law and Practice of Bankruptcy" by Henry C. Black, 4th ed., p. 875.

[22] Public Act No. 696, 75th Congress, 3d Session, Sec. 70.

the filing of a petition in bankruptcy are invalid. In the first place, every transfer made and every obligation incurred by a debtor within four months prior to the filing of a petition in bankruptcy is fraudulent against existing and future creditors if the transfer was made or the debt was incurred with the intent to use the consideration obtained for the transfer or obligation to effect a preference to a third person in violation of certain provisions of the act. In the second place, every lien obtained within four months prior to the filing of the petition in bankruptcy is null and void if at the time when the lien was obtained the person was insolvent.[23]

As has been previously mentioned, one of the duties of a trustee is to pay dividends. Before dividends may be declared and paid to general creditors whose claims have been allowed, certain debts having priority must be discharged. In the first place, creditors who hold valid liens on specific property are entitled to have their claims satisfied from the proceeds of that property when sold by the trustee.[24] In the second place, there are several classes of debts which must be paid from the general assets of the estate before the payment of dividends. All taxes due to the United States, to a state, to a subdivision of a state, or to a municipality have been placed in a preferred class. Also, the various costs incurred in the conduct of bankruptcy proceedings have been given priority. In this latter class are the costs of preserving the estate subsequent to the filing of a petition, witness fees, and one reasonable fee for an attorney. Wages have been accorded a preference provided they have been earned within three months prior to the date of the commencement of bankruptcy proceedings and do not exceed $600 for each claimant.[25]

As has been previously pointed out, one of the duties of a trustee is to set aside the exemptions to which a bankrupt is entitled and to report them to the court. It is obvious that humane and social considerations demand that some of the property of a debtor should be immune from seizure. The Bankruptcy Act has recognized this principle by providing for

[23] Public Act No. 696, 75th Congress, 3d Session, Sec. 67.

[24] See "A Treatise on the Law and Practice of Bankruptcy" by Henry C. Black, 4th ed., p. 813.

[25] Public Act No. 696, 75th Congress, 3d Session, Sec. 64. For a discussion of priorities see Collier on Bankruptcy, 1931 ed., p. 996.

exemptions. This part of the law is interesting because no definite amount and no list of exempt property are prescribed. The Bankruptcy Act merely adopts various state laws by declaring that the provisions of the Bankruptcy Act are not to affect the allowance to bankrupts of the exemption prescribed by the state laws that are actually in force at the time of the filing of a petition.[26]

This section of the Federal act dealing with exemptions has given rise to some interesting constitutional questions. The Constitution states that Congress shall have the power to provide for *uniform* laws on the subject of bankruptcies. It has been alleged that a provision which permits exemptions which vary according to the laws of the different states does not meet the constitutional requirement of uniformity. However, the courts have upheld the constitutionality of this part of the act and have pointed out that the general operation of the law is uniform, even though in certain particulars it may result differently in different states.[27]

The state laws on the subject of exemptions present much variation. In some of them such items as wearing apparel, tools of trade, homesteads, domestic animals, and household furniture are exempt. In other states no particular items are specified, but the debtor is allowed an exemption for property which does not exceed a certain amount in value.[28]

The bankrupt is entitled also to exemptions under various statutes of the United States. For example, one act exempts military arms and equipment, and another declares that pension money due from the United States to a pensioner is not liable to seizure. With regard to such pension money one court has held that, so long as this money remains unchanged in the hands

[26] Public Act No. 696, 75th Congress, 3d Session, Sec. 6.

[27] Hanover Nat. Bank v. Moyses (1902) 186 U. S. 181, 46 L. Ed. 1113, 22 S. Ct. 857.

[28] See, for example, Burns' Indiana Statutes Annotated, 1933, Sec. 2-3501. "An amount of property . . . not exceeding in value one thousand dollars owned by such resident householder shall not be liable for sale on execution or any other final process from a court, for any debt growing out of or founded upon contract, express or implied . . . "

of a pensioner at the time of filing a petition, it is not liable to seizure through bankruptcy proceedings.[29]

3. *The Discharge of a Bankrupt.* An important feature of the Bankruptcy Law is that which provides for the discharge of the bankrupt. A discharge in bankruptcy releases the debtor from most of his financial obligations. The adjudication in bankruptcy of any person except a corporation operates as an application for a discharge. A corporation may within six months after its adjudication file an application for discharge. After the bankrupt has been examined, the court is to fix a time for filing objections to his discharge. The applicant is entitled to a discharge unless he has committed an offense against the bankruptcy laws punishable by imprisonment; unless he has destroyed, mutilated, or failed to keep certain records from which his financial condition might be ascertained; unless he has obtained credit through a false statement in writing concerning his financial condition; unless he has within six years been granted a discharge in bankruptcy or has had a composition arrangement; unless he has refused to obey any lawful order or refused to answer any material questions approved by the court; unless he has failed to explain satisfactorily any losses or deficiencies of assets; or unless he has with intent to delay, hinder, or defraud his creditors transferred, removed, destroyed, or concealed any of his property within 12 months immediately preceding the filing of the petition.[30]

A discharge in bankruptcy relieves the debtor from the obligation to pay most of his previously incurred debts. There are a few exceptions, however. His discharge does not relieve him from the payment of taxes or alimony. It does not relieve him from liability for money obtained under false pretenses, malicious injury to persons or property, seduction, or criminal conversation. It does not relieve him from liability for debts created by fraud, embezzlement, or misappropriation while acting in some fiduciary capacity. Nor does the discharge operate to relieve him from the payment of certain unscheduled claims unless the

[29] *In re* Bean (1900) 100 Fed. 262. For a list and discussion of the exemptions created by U. S. Statutes see "A Treatise on the Law and Practice of Bankruptcy" by Henry C. Black, 4th ed., p. 560.

[30] Public Act No. 696, 75th Congress, 3d Session, Sec. 14.

creditor had notice or knowledge of the proceedings in bankruptcy. Furthermore, the bankrupt is still under the obligation to pay wages which have been earned by employees within three months from the date of the commencement of proceedings in bankruptcy. Finally, the bankrupt is under the obligation to pay certain money which he has received or retained in order to secure the faithful performance of the terms of a contract of employment.[31]

4. *Criminal Provisions.* In order to aid in its enforcement, the Bankruptcy Act contains certain criminal provisions. It is a crime for a trustee, a receiver, or other officer of the court knowingly and fraudulently to appropriate, to spend, or to transfer unlawfully any property or to secrete or destroy any document belonging to the estate of the bankrupt. It is a crime for any person to conceal from the trustee any property belonging to the estate. It is a crime also for any person to make a false oath or account in relation to bankruptcy proceedings; to present a false claim against the estate; to receive any property from a bankrupt after the filing of a petition in bankruptcy with the intention of defeating the provisions of the Bankruptcy Act; to receive any money or property from any person as compensation for acting or forbearing to act in bankruptcy proceedings; to conceal, mutilate, or destroy books or records after the filing of the petition in bankruptcy; or to withhold books or documents from a receiver or trustee. Finally, it is a crime for a referree knowingly to act in a case in which he is directly or indirectly interested, to purchase any property of the estate, or to refuse an opportunity for inspection of accounts.[32]

5. *Criticism of the Bankruptcy Law and Procedure.* During the past few years the whole system of bankruptcy in the United States has been much discussed and criticized. Critics have alleged that it has failed to achieve its fundamental purposes. A 1932 report of the attorney general made the following striking comment:

> The bankruptcy court has increasingly become a dumping ground for the refuse of commercial wreckage, and a sanctuary where debtors obtain cancellation of their debts regardless of how they may have wasted their property. As a medium of distribution the bankruptcy

[31] Public Act No. 696, 75th Congress, 3d Session, Sec. 17.

[32] Public Act No. 696, 75th Congress, 3d Session, Sec. 29.

act has ceased to have any importance to the mercantile community except in a very small percentage of cases.[33]

The number of cases concluded annually increased from 15,000 in 1921 to 60,000 in 1930.[34] In many of these cases financial difficulties were due to misfortune, miscalculation, or some other excusable circumstances. In a few cases bankruptcy was probably deliberately planned as a shrewd method of doing business.[35] In other cases bankruptcy was merely an easy and almost painless method of escaping from personal debts. That this last was frequently the situation appears to be borne out by the fact that of the 60,000 cases concluded in 1930, 50 per cent involved wage earners.[36] Barring misfortune, wage earners have less excuse than persons who are engaged in commerce for getting themselves into financial difficulties. Installment buying, easy credit, and high pressure salesmanship, however, undoubtedly tempted large numbers of persons to purchase luxuries which they could ill afford, and then when financial pressure became too great, they sought relief through bankruptcy.

One of the worst features of the bankruptcy situation was the tremendous losses to creditors. In about 65 per cent of the cases concluded in 1930 there were no assets.[37] In a much larger percentage there were no dividends because the costs of administration swallowed up the few remaining assets. It has been estimated that the losses to creditors during the five years from 1925 to 1929 reached the staggering figure of $3,800,000,000, and that the average dividend paid during that period was 8½ cents on the dollar.[38]

From a consideration of the above it is evident that there have been serious weaknesses in the bankruptcy system. In 1938 Congress made extensive revisions in the Bankruptcy Act and

[33] Report of the Attorney General on Bankruptcy Law and Practice, p. 6, Sen. Doc. No. 65, 72d Congress, 1st Session.

[34] Report of the Attorney General on Bankruptcy Law and Practice, p. 3, Sen. Doc. No. 65, 72d Congress, 1st Session.

[35] See the article in 226 *North American Review* 597, "Fail, Fail Again" by George S. Brooks.

[36] See Annual Report of the Attorney General, 1930, p. 41.

[37] See the Report of the Attorney General on Bankruptcy Law and Practice, p. 7, Sen. Doc. No. 65, 72d Congress, 1st Session.

[38] See the article by Thomas D. Thacker in *N. Y. State Bar Association Bulletin*, October, 1930, p. 443.

corrected some of the more glaring weaknesses. Certain improvements have been made in those parts of the act which prohibit the transfer of assets during the period preceding the filing of a petition in bankruptcy. Likewise, the provisions dealing with the discharge of a bankrupt have been amended. Furthermore, the amendments of 1938 have attempted to prevent excessive expenditures in connection with the administration of bankrupt estates.[39]

However, many of the weaknesses of our bankruptcy system have not been corrected by the amendments of 1938. It is still an underlying principle of the Bankruptcy Act that the creditors are the only persons concerned in bankruptcy cases and that by reason of their self-interest they can be relied upon to achieve an equitable and maximum distribution of assets. But the self-interest of creditors does not seem adequate to secure in all cases the efficient and diligent administration of estates. Furthermore, society in general as well as the creditors has an interest in bankruptcy proceedings. If an undeserving or unscrupulous bankrupt is allowed to escape, he may be tempted to repeat his experience at the expense of more honorable members of the community.

Another weakness is to be found in the administrative machinery of the act. There are about 500 referees. Since there is no coordinating or unifying agency, there is much variation in bankruptcy proceedings and in the quality of work in the various jurisdictions. This variation has been well summarized in the following words:

> Anyone who travels from one referee's court to another will soon gain the impression that a different bankruptcy law applies to each. This is true not only with respect to the different districts, but generally with respect to the different referees within a district.[40]

In order to bring about uniformity in practice and procedure, one suggestion for change in the Bankruptcy Act would provide 10 administrators, each of whom would supervise a group of referees.[41] A more radical proposal would take the administra-

[39] Public Act No. 696, 75th Congress, 3d Session, Sec. 48.

[40] See the Report of the Attorney General on Bankruptcy Law and Practice, p. 27, Sen. Doc. No. 65, 72d Congress, 1st Session.

[41] See the Report of the Attorney General on Bankruptcy Law and Practice, p. 104, Senate Doc. No. 65, 72d Congress, 1st Session.

tion of bankruptcy out of the hands of the courts, referees, trustees, and creditors and would place it in a government bureau or commission.

II. Other Procedure for the Relief of Debtors.

The effects of the depression upon the debtor class made it almost imperative for Congress to provide other relief for debtors in addition to that afforded through regular bankruptcy proceedings. By laws passed in 1933, 1934, and 1938 Congress attempted to solve this problem. Special provisions were enacted which permitted the composition of debts of local governmental units, reorganization of railroads, reorganization of corporations, arrangements for wage earners, and arrangements for other persons.

1. *Composition of Local Government Debts.* Any municipality or other local taxing unit of a state may file a petition in a district court stating that it is insolvent or unable to meet its debts and that it desires to effect a plan for the composition of its debts. In the case of most governmental units the petition must state that the creditors owning not less than 51 per cent of the securities affected have accepted the plan in writing. The judge is to approve the petition if he is satisfied that it has been filed in good faith and complies with the law. The plan of composition may include provisions for modifying the rights of creditors and it may contain such other provisions as the parties desire. After hearing objections the judge may confirm the plan. However, the plan is not to be confirmed unless it has been accepted by creditors holding at least two-thirds of the aggregate amount of claims of all classes affected by the plan. Upon confirmation, the provisions of the plan are binding upon all creditors.[42]

2. *Railroad Reorganization.* Special statutory provisions have been enacted which permit the reorganization of railroad corporations. Under these provisions a petition may be filed stating that a railroad corporation is insolvent or unable to meet its debts and that a reorganization is desired. Such petition may be filed by the railroad or by creditors having claims which aggregate not less than 5 per cent of the indebtedness of the railroad. The petition must be approved by the judge, who

[42] Public Act No. 302, 75th Congress, 1st Session.

then appoints a trustee to operate the business. A hearing must be held before the Interstate Commerce Commission on proposed plans of reorganization. A plan may be presented by the trustee, the debtor railroad, or 10 per cent or more in amount of any class of creditors. After the hearing, the Interstate Commerce Commission either recommends one of the proposed plans or suggests a new one. The plan must be accepted by a certain percentage of the stockholders. The commission then certifies the plan to the court and after a hearing the judge is to confirm the plan if the designated conditions have been met.[43]

3. *Corporate Reorganization.* Under the Bankruptcy Law corporations are permitted to "scale down" their stock or bonded indebtedness through reorganization procedure. A corporation or three or more creditors who have claims against a corporation or its property amounting in the aggregate to at least $5,000 may file a petition in a district court of the United States stating that the corporation is insolvent or unable to pay its debts and may present a plan of reorganization. If the judge is satisfied that the plan complies with the requirements of the law and that it has been filed in good faith, he is to enter an order approving the petition and is to appoint one or more trustees who are to take possession of the property and operate the business of the corporation. In the case of small corporations the judge may continue the debtor in possession. The trustee is to investigate the acts, conduct, property, liabilities, the financial condition of the debtor, and the operation of the business. The trustee is also to prepare and file a plan for reorganization. After a hearing, the judge may approve the plan. A plan must be accepted by creditors holding two-thirds in amount of the claims filed and allowed against the corporation and must be approved by the judge.[44]

4. *Wage Earners' Plans.* The Bankruptcy Law makes special provision for the financial relief of *wage earners.* According to the law, a wage earner is any person who works for wages, salary, or hire at a rate of compensation which when added to all other income does not exceed $3,600. Such person may file a petition stating that he is insolvent or unable to pay his debts as they

[43] Public Act No. 381, 74th Congress, 1st Session.

[44] Public Act No. 696, 75th Congress, 3d Session, Secs. 106–238.

mature and that he desires to effect a composition or to obtain an extension of time out of his future earnings or wages. The judge or referee then calls a meeting of the creditors and the wage earner submits his plan. If the plan is accepted by the creditors, the court appoints a trustee to receive and distribute all money to be paid under the plan. The court is to confirm the plan if it is for the best interests of the creditors, if it is fair, equitable, and feasible, if the debtor has not been guilty of any acts which would be a bar to the discharge of a bankrupt, and if the proposal and acceptance are in good faith. In general, the debtor is not to be adjudged a bankrupt during the pendency of these proceedings.[45]

5. *Debtors' Arrangements.* Any debtor who could become a bankrupt under the Bankruptcy Act may file a petition with a court stating that he is insolvent or unable to pay his debts as they mature and may propose an *arrangement* with his creditors. The court calls a meeting of the creditors, who are given an opportunity to accept the proposed arrangement. After the acceptance a trustee or receiver is appointed and the court is to confirm the arrangement. The trustee or receiver has the power subject to the control of the court to operate the business and manage the property of the debtor.[46]

Any debtor other than a corporation may file a petition stating that he is insolvent and that he wishes to make a *real property arrangement.* Such an arrangement is a plan for the alteration of the rights of creditors who hold debts secured by real property.[47]

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Public Act No. 696, 75th Congress, 3d Session, Secs. 1, 2, 3, 4, 6, 14, 17, 19, 29, 38, 39, 44, 47, 58, 59, 64, 67, and 70.

In re Dwyer (1911) 184 Fed. 880.

[45] Public Act No. 696, 75th Congress, 3d Session, Secs. 601–668.

[46] Public Act No. 696, 75th Congress, 3d Session, Secs. 306–380.

[47] Public Act No. 696, 75th Congress, 3d Session, Secs. 401–497.

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CHAPTER XXII

PATENTS, COPYRIGHTS, AND TRADE-MARKS

The control of patents and copyrights is exercised exclusively by the Federal government which derives its power from Article I, Section 8 of the Constitution of the United States. The so-called "patents and copyrights clause" of Article I, Section 8, reads as follows:

> Congress shall have power . . . to promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.

The authorship of this clause is somewhat obscure, although Charles Pinckney is often accorded the honor and credit for being its originator and sponsor.[1] The reasons for giving this power to the Federal government are also obscure. In the first place, this provision was probably designed to give to inventors more protection than they had under the early laws of the states. At common law an inventor had no exclusive rights to his invention. Most of the states had copyright statutes at the time of the adoption of the Constitution. Apparently only one state had any kind of general patent law, although patents were granted by special acts of the legislatures.[2] In the second place, the framers of the Constitution probably felt that state control even at its best would not be particularly effective. This assertion appears to be borne out by Madison, who in *The Federalist* declares, "The States cannot separately make effectual provision for either of these cases . . . "[3] Regardless of the reasons for its adoption and the source from which it sprang, this provision does not seem to have provoked much comment or discussion

[1] See "History of the Origin, Formation, and Adoption of the Constitution of the United States" by George T. Curtis, Vol. II, p. 339.

[2] See "The Origin of the Patent and Copyright Clause of the Constitution" by Karl Fenning, 17 *Georgetown Law Journal* 109 (115).

[3] See *The Federalist*, No. XLIII.

either in the convention or during the period of the adoption of the Constitution by the states.

The constitutional power of the Federal government over trade-marks comes from the commerce clause. As a result, both states and the Federal government may exercise some control. Congress has legislation pertaining to those trade-marks which are used in interstate commerce, and the several states have laws covering trade-marks for businesses which are intrastate in character.

I. The Issuance and Protection of Patents.

The organization charged with examining and granting or refusing the applications of inventors is the Patent Office. Although the first patent law was approved by Washington in 1790, the Patent Office itself did not originate until a later date.[4] In 1802 Jefferson appointed a superintendent of patents. In 1836 the title of commissioner of patents was created, and the foundation was laid for the present organization of the Patent Office. At first the Patent Office was attached to the Department of State; later it was made a subordinate division of the Department of the Interior; and in 1925 by presidential decree it was transferred to the Department of Commerce.

The commissioner of patents is in charge of the office. He is aided by one first assistant commissioner, two assistant commissioners, nine examiners in chief, and certain other officials, among whom are about six hundred examiners of various grades.

Each year the Patent Office receives a flood of applications. For the fiscal year ending June 1931 more than 106,000 applications were filed. During the interval between 1836 and 1937, the office had granted more than 2,000,000 patents. Printed descriptions of patents are kept. One of these may be secured by any interested person for the small sum of 10 cents.

The most important publication of the Patent Office is the *Official Gazette*. This document, which appears weekly, contains a vast quantity of information on patents and trade-marks, such as drawings and descriptions of the patents which have been granted, illustrations of trade-marks for which applications have been made, lists of trade-marks, prints and labels which

[4] For the first Patent Law see 1 Stat. L. 109.

have been registered, and decisions in patent and trade-mark cases.

The Patent Office is one of the few branches of the Federal government which is nearly self-supporting. The fees which it collects from applicants pay most of the costs of its operation.[5]

1. *Persons Entitled to a Patent.* At this point a word should be said concerning the nature of a patent. The grant which is made to a successful applicant is called "letters patent." Some courts have declared that this grant is a kind of contract between the United States and the patentee under which the government gives to an inventor certain exclusive rights for a limited period of time in consideration of the fact that he has perfected, described, and granted the use of an invention to the public forever thereafter.[6] A patent has been regarded also as a species of personal property of an incorporeal and intangible nature. As such it may be sold, passed on by will, and otherwise treated in much the same way as other personal property of a similar nature.[7]

Any person who has invented or discovered anything new and useful which falls into one of the classes specified by the statute may apply for and obtain a patent. It matters not whether such person is a child or an adult, a citizen or an alien. Nor does it matter whether he is a private person or a government employee, with the one exception that an employee of the Patent Office may not secure a patent. Even joint inventors may apply for and receive a patent although neither one may do so alone.

The inventor or discoverer is the party who must file the *application.* An assignee may not apply. Thus it is impossible for a corporation to make an application. However, an individual may assign his patent rights to a corporation. The only

[5] For a short description of the organization and history of the Patent Office see the article by Thomas E. Robertson, commissioner of patents, *U. S. Daily* for Nov. 8, 1928, p. 9; see also Service Monograph of the U. S. Govt., No. 31, Institute for Govt. Research.

For the statutory provisions dealing with organization, see U. S. Code, Title 35, Secs. 1–23.

For the number of applications received, and the receipts and expenditures of the Patent Office, see the annual reports of the commissioner of patents, 1929 to 1931.

[6] See Jewell Filter Co. v. Jackson (1905) 140 Fed. 340.

[7] See Corpus Juris and cases cited there, Vol. 48, p. 18. See also Fruit-Cleaning Co. v. Fresno Home-Packing Co. (1899) 94 Fed. 845.

exceptions to the rule that the inventor must file the application arise from the death or insanity of the inventor. In such eventualities the guardian, the executor, or the administrator may apply for a patent.[8]

2. *Inventions or Discoveries Which May Be Patented.* The patent laws enumerate the kinds of inventions or discoveries for which patents may be obtained. A patent may be obtained for the invention or discovery of a *machine, art, composition of matter*, or *manufacture*.[9] A patent may be obtained also for the creation of a new kind of *plant*. Finally a patent may be secured for the creation of a new *design*. Although the word "discovered" is used alongside the word "invented" in the statute, no valid patent can be obtained for the discovery of a scientific truth or the discovery of some new element. No matter how brilliant or important the discovery, some practical application of it must be made before a patent can be obtained.[10] As a result, the scientist is not rewarded for the fruits of his labor as is the inventor. Furthermore, a patent cannot be obtained for a mere idea. In order to secure a patent the means and manner of operation of the invention must be worked out in detail.

The word *machine* as used in the statute obviously refers to some mechanical device. A *composition of matter* refers to such products as dyes, soaps, medicines, or paints. An *art* means some process or method of treating certain materials so as to produce a new result. The term *manufacture* has caused the most difficulty. This term includes whatever is made by the art or industry of man, whether by hand or machinery, which is not a machine, composition of matter, or a design.[11] Such things as baseball masks, hat linings, and bottle caps are illustrations of objects which are patentable as manufactures.[12]

The rule that a patent may be obtained for a machine, an art, a composition of matter, or a manufacture, has two important qualifications. The invention must be *new* and it must be

[8] U. S. Code, Title 35, Sec. 46.

[9] U. S. Code, Title 35, Sec. 31.

[10] See Leroy v. Tatham (1860) 22 How. 132, 16 L. Ed. 386.

[11] Johnson v. Johnston (1894) 60 Fed. 618.

[12] See Kurtz v. Belle Hat Lining Co. (1922) 280 Fed. 277; American Metal Cap Co. v. Anchor Cap and Closure Corp. (1921) 278 Fed. 670; Goldsmith v. Johnstone (1924) 294 Fed. 756.

useful. In other words, the device must have novelty and it must have utility.[13]

In dealing with the qualification, novelty, the law contains several provisions. In the first place, the device cannot be patented if it was known or used by others in this country before the time of the alleged invention. Moreover, the device need not have been in general use to make it unpatentable; a limited use is enough, provided that such use is public and not concealed or kept secret.[14] In the second place, the law provides that the device cannot be patented if it has been patented or described in a printed publication by some other person in a foreign country before the date of invention or more than one year prior to the date of application. This qualification is much more limited than the previous one as it is not mere prior knowledge or use in a foreign country which renders the invention unpatentable, but it is the actual patent of the device abroad or its description in some printed publication. In the third place, the statute provides that a patent cannot be obtained if the invention has been on sale or in public use in this country more than one year prior to the date of application.[15] This is an important qualification. The purpose appears to be to prevent an inventor from prolonging the period of his monopoly by a delay in applying for a patent. A failure to observe this last qualification may result in the permanent loss to an inventor of valuable monopolistic rights.[15]

Before leaving the subject of novelty a few more points should be noted. In order to satisfy this requirement, the invention must be one which is not obvious to anyone who is skilled in the trade but must show some real ingenuity on the part of the inventor beyond the mere exercise of mechanical skill.[16] It is unnecessary that the entire device be new; a slight improvement will often suffice. Of course such improvement may be of little value to the patentee unless he owns or can use the basic patent.

[13] U. S. Code, Title 35, Sec. 31.

[14] See Bedford v. Hunt (1817) Case No. 1217, 3 Fed. Cases 37, 1 Mason 302.

[15] Public Act No. 286, 76th Congress, approved Aug. 5, 1939.

[16] Smith v. Magic City Kennel Club (1931) 282 U. S. 784, 75 L. Ed. 707, 51 S. Ct. 291.

A mere increase in size does not provide the novelty necessary to make an invention patentable.[17]

As previously stated, a machine, an art, a composition of matter, or a manufacture must have *utility* to be patentable. A slight degree of utility, however, will satisfy this requirement. It is unnecessary that the device accomplish better or even as well the purpose for which it is made, as does another similar device which has already been patented. Nor is it necessary to show that the product will be a commercial success. However, a machine must perform the functions for which it has been invented or the patent is void for want of utility.[18]

The requirement that a device must be useful makes impossible the patenting of a few inventions which are new and original. An invention which is dangerous but not useful cannot be patented.[19] Similarly, it has been held that a device such as a toy automatic race course whose sole use is for gambling cannot be patented.[20] The law on this point has been well stated by an outstanding authority:

> Utility is negatived if the function performed by an invention is injurious to the morals, the health, or the good order of society. An invention to improve the art of forgery, or one to facilitate the spread of contagious disease, or one to render air or water intoxicating, would of course be unpatentable for want of utility.[21]

However, a device whose sole merit lies in its power to divert or amuse appears to satisfy the statutory requirement of utility.[22]

Since an amendment of 1930 a person who invents or discovers and asexually reproduces any distinct and new variety of plant can obtain a patent.[23] The same limitations as to novelty which were mentioned previously in connection with patents of machines and other inventions apply to patents for plants. That is to

[17] See Bonnot Co. v. Lopulco Systems (1926) 15 Fed. 2d 848.

[18] See Walker on Patents, 1929 ed., p. 146.

[19] See the statement of the court in Converse v. Cannon (1873), Case No. 3144, 6 Fed. Cases 370, 2 Woods 7.

[20] National Automatic Device Co. v. Lloyd (1889) 40 Fed. 89.

[21] See Walker on Patents, 1929 ed., p. 148.

[22] See the statement of the court in Paul Boynton Co. v. Morris Chute Co (1897) 82 Fed. 440.

[23] U. S. Code, Title 35, Sec. 31.

say, the production must not have been known or used by others in this country before its discovery. It must not have been patented or described in any printed publication in this or a foreign country before its discovery or more than two years prior to the date of application. It must not have been on sale or in public use in this country more than two years prior to the date of application. The issuance of patents to creators of new varieties of plants represents the extension of monopolistic rights to an entirely new field. The purpose is to encourage new developments in horticulture and agriculture by rewarding discoveries in these fields to the same extent that inventors in other fields are rewarded.

The law provides that any person who has invented a new, original, and ornamental design for an article of manufacture may obtain a patent. However, the design must not have been known or used in the United States before the date of invention or patented or described in any printed publication in this or in any foreign country before the date of invention or more than two years prior to the date of application, or must not have been in public use or on sale more than two years prior to the date of application for a patent.[24]

The requirements for design patents differ somewhat from the requirements for other patents. In the first place, the design must be attached to some article of manufacture, such as chinaware, carpets, silverware, or automobiles. Although a patent cannot be obtained for a design which is not attached to some article, the patent is for the design and not the article. For example, where a person secured a patent for a design in solid silver and another person used the design in plated ware, the patent was held to have been infringed.[25]

The design may be the result of some configuration or shape in the article itself or may consist of ornamentation upon the article. Although the law does not require that the invention be useful, it must be new, original, and ornamental. Therefore the court held that no patent could be obtained for a design which consisted merely of squaring a candle. Such an idea might occur to almost any person, and the right to make a round

[24] U. S. Code, Title 35, Sec. 73.

[25] Dominick and Haff v. R. Wallace and Sons Mfg. Co. (1913) 209 Fed. 223.

object square should be open to all persons alike.[26] Undoubtedly design patents cannot be obtained for figures consisting of such well-known historic objects as Greek columns or the Sphinx because designs embodying such figures do not seem to possess the requisite originality.

As has been previously stated, a design to be patentable must be ornamental as well as novel. The Court of Customs and Patent Appeals has stated, however, that the beauty requisite in design patents is not confined to things pertaining to aesthetics or the fine arts. The court held that the Patent Office had erred in refusing a design patent for a concrete mixer which made the machine, the gas tank, the engine, the mixer, and the body into a symmetrical and compact whole.[27]

3. *The Procedure for Obtaining a Patent.* To secure a patent involves much time and minute attention to detail. So difficult is the procedure and so technical are the requirements that the Patent Office advises no person to proceed without the aid of a competent patent attorney.[28]

The first step is the filing of application papers in the Patent Office. A *petition* is required which must be signed by the applicant giving his name, residence, post office address, and the title of the invention. The petition must be accompanied by a full, written description of the invention called the *specification.* The specification must be very clear, concise, and exact, and must conclude with a statement of the claims of the inventor as to the part which he regards as his invention. The importance of this part of the application cannot be overemphasized since the invention as set forth in the claims is the subject of the patent. The petition must be accompanied also by a *drawing* of the invention provided, of course, that it is such as to permit reproduction in this form. The petitioner may be called upon by the Patent Office to furnish a model, but ordinarily such demand is not made. An affidavit is required stating that the applicant believes himself to be the first and true inventor of the device which he is seeking to patent. Finally, the petition must be accompanied

[26] Knapp v. Will and Baumer Co. (1921) 273 Fed. 380.

[27] *In re* Koehring (1930) 37 Fed. 2d 421.

[28] See the *Bulletin* of the Patent Office entitled "General Information Concerning Patents," 1929, p. 2.

by the required fee.[29] The fees payable in making an application vary with the nature of the invention. In the case of most patents, a fee of $30 is required for filing and another of $30 must be paid upon the issuance of a patent.[30]

The next step in the procedure is an examination by the Patent Office. The application is turned over to one of the numerous examiners whose duty it is to determine whether or not the application is in proper form and whether or not the invention is patentable. If the invention satisfies these requirements, the patent is granted. If, however, the application is not approved, the office notifies the petitioner and gives reasons for its rejection. Upon request the application will be reexamined either with or without alteration of the specifications. An applicant may amend as often as the examiner gives new reasons for refusing a petition.[31]

In case two or more persons claim to have invented the same thing, an *interference* is declared for the purpose of determining the question of priority between the conflicting claims. The statutory provision which covers this point states that whenever an application is made for a patent which the commissioner believes would interfere with any pending application or an unexpired patent, he shall give notice to the proper parties and direct a board of interference examiners to determine priority.[32]

The law provides for many appeals from a decision of an examiner. In the first place, every applicant for a patent whose claims have been twice rejected may appeal from the decision of an examiner to the Board of Appeals, consisting of the commissioner of patents, the first assistant commissioner, the assistant commissioners, and the examiners in chief.[33]

[29] U. S. Code, Title 35, Secs. 33–35. See also "Patents Trade-marks and Copyrights" by Oscar Geier, p. 10; and the *Bulletin* of the Patent Office, "General Information Concerning Patents," 1929, p. 5.

[30] U. S. Code, Title 35, Sec. 78.

[31] See the *Bulletin* of the Patent Office, "General Information Concerning Patents," 1929, p. 7.

For a description of the procedure, see "Patent Law for Chemists, Engineers, and Executives" by Fred H. Rhodes, Chaps. VIII and IX.

[32] U. S. Code, Title 35, Sec. 52, as amended by Public Act No. 287, 76th Congress, approved Aug. 5, 1939.

[33] U. S. Code, Title 35, Secs. 7 and 57, as amended by Public Act No. 287, 76th Congress, approved Aug. 5, 1939.

If an applicant or a party to an interference proceeding is dissatisfied with the decision in the Patent Office, an appeal may be taken to the Court of Customs and Patent Appeals.[34] An applicant whose request for a patent has been denied by the commissioner of patents has an alternative method of review which he may pursue. He may seek a review by asking for a bill in equity from the proper district court. Such court may adjudge that the applications should be granted and order the commissioner of patents to issue a patent.[35]

4. *The Rights of a Patentee.* An inventor or discoverer obtains no exclusive rights to his invention until he secures a patent. The common expressions, "patents pending" or "patents applied for," have no legal effect in excluding others from the use, sale, or manufacture of the invention.

The grant of a patent is for a period of 17 years from the date of its *issuance* except for design patents, which are issued for periods of 3½ years, 7 years, or 14 years.[36] A patent may not be extended except by special act of Congress.

During the life of a patent the owner has the exclusive right to *use*, to *make*, and to *sell*, the invention throughout the United States and its territories. Actually, of course, the patent does not give an inventor the right to make, use, or sell his product, because he had that right before its issuance. It does give him the right *to exclude* others from the performance of these three acts. Although the statute is silent on the point, it seems now to be well settled that an inventor has the right of nonuse to his invention.[37]

Patented products should be plainly and conspicuously marked on the machine, article, or package by placing thereon the word "patent" together with the number. The chief significance of so marking the invention is for purposes of recovery of damages in case of infringement. A plaintiff cannot recover damages unless the article has been marked as required or unless the defendant has been notified of the infringement and continues thereafter to make, sell, or use the invention.[38]

[34] U. S. Code, Title 35, Sec. 59.
[35] U. S. Code, Title 35, Sec. 63.
[36] U. S. Code, Title 35, Secs. 40 and 77.
[37] See "Economics of Our Patent System" by Floyd L. Vaughan, p. 161.
[38] U. S. Code, Title 35, Sec. 49.

A patent or interest therein can be assigned by an instrument in writing. However, such an assignment must be recorded in the Patent Office; otherwise it will be void as against a purchaser or mortgagee for valuable consideration without notice.[39] An assignment may be made even before the date of the issuance by the Patent Office of the "letters patent." It is possible, also, to assign exclusive patent rights for only a part of the United States. It is possible, likewise, to convey only a part of one's patent rights. As was stated before, there are three exclusive rights belonging to the owner of a patent, the rights to make, use, and sell. Unless all three of these are transferred, the transaction is usually spoken of as a license.[40] By means of licensing, the owner may retain the title to a patent and confer a part of his monopolistic rights upon one person and a part upon another, thereby enabling him to realize the maximum profit from his invention. A license is purely personal and cannot be transferred without the consent of the licensor.

5. *The Remedies for Infringement.* The Patent Office is charged with issuing patents but it is not entrusted with the duty of preventing infringement. Owners of patents must turn to the several federal district courts for the protection of their rights.

Infringement of a patent consists of making, selling, or using the invention without the consent of the owner during the period of the monopoly. However, a person who makes, sells, or uses the invention without the consent of the owner even after "letters patent" have been issued does not necessarily infringe another's patent. The grant of a patent by the Patent Office is not conclusive as to its validity. If the patent is found to be invalid, obviously the defendant has not been guilty of infringement.

The several district courts of the United States have original and exclusive jurisdiction in all cases arising under the patent laws of the United States.[41] In general, their jurisdiction covers suits involving infringement, title, or the validity of patents.

[39] U. S. Code, Title 35, Sec. 47.

[40] Oliver v. The Rumford Chemical Works (1883) 109 U. S. 75, 27 L. Ed. 862, 3 S. Ct. 61; U. S. v. Gen. Elec. Co. (1926) 272 U. S. 476, 71 L. Ed. 362, 47 S. Ct. 192.

[41] U. S. Code, Title 28, Secs. 41(7) and 371.

There are two classes of remedies which the statute gives to persons to protect them against the infringement of their patent rights. In the first place, a party may proceed by action at law to recover damages which he has suffered as a result of an infringement. In such case, if a verdict is found for the plantiff, the court may enter judgment for any sum above the damages found by the jury. However, the sum may not exceed three times the amount of the verdict.[42] In the second place, a party may proceed in equity to protect his rights. He may secure a preliminary and later a permanent injunction to restrain further infringement. He may also recover in equity not only the damages which he has suffered but also the profits which the defendant has made from the alleged infringement.[43]

6. *Criticism of the Patent System.* The entire system of patent monopoly has been subjected to numerous and severe criticisms and attacks. Many persons allege that it is not fulfilling its proper function of encouraging, rewarding, and protecting inventors and conferring the benefits of their labors on society.

One of the objections to the system arises from the suppression of patents. The charge has been made that certain companies purchase and deliberately suppress competing patents in order to gain a monopoly in their field. Although accurate information is impossible to obtain, there is little doubt but that some corporations have engaged in this practice. For example, if one company owns a series of patents for machines which are used for the same purpose, one can reasonably infer that many of these are being held merely to retain monopolistic control. In order to prevent this abuse, the suggestion has been made that a system of compulsory licensing would be desirable. Under such an arrangement, the persons who do not use or make their patented articles within a given period of time are required to license them to other persons who desire to make or use the inventions. Compulsory licensing has been tried in England.[44] Apart from the practicability or social desirability of such a scheme, there is grave doubt as to its constitutionality. The Constitution gives to Congress the power to grant *exclusive* rights to inven-

[42] U. S. Code, Title 35, Sec. 67.

[43] U. S. Code, Title 35, Sec. 70.

[44] For a brief discussion of compulsory licensing in England, see "Principles of the Law of Personal Property" by Joshua Williams, 17th ed., p. 361.

tors. An exclusive right to an invention might reasonably be held to include its nonuse.[45]

Another criticism of our patent system is the cost and time necessary for establishing and defending patent rights. The amount of litigation over patents is prodigious. Such litigation is often costly and long-drawn-out. A party desirous of wearing out or harassing an opponent has plenty of opportunities to employ dilatory tactics. It is possible to delay the issuance of a patent by filing an application for an interference proceeding. The appeal through the Patent Office and up to the Court of Customs and Patent Appeals consumes considerable time. At the end of that time a patentee may find that a rival is making or using his invention. This necessitates a suit in a district court for infringement. Even a favorable decision in a lower court does not conclude the case. An appeal may be taken to a circuit court of appeals, and under some circumstances a review may be obtained in the Supreme Court of the United States. Patentees who have only limited funds find it almost impossible to defend their rights. Even corporations with extensive financial resources may lose all their profits from an invention or may even be brought to the brink of disaster by protracted patent litigation.

The causes which give rise to extensive patent litigation are numerous. Some of the litigation undoubtedly represents deliberate attempts to harass and embarass owners of patent claims whose financial resources make it impossible for them to withstand long-sustained legal battles. Another reason for patent litigation is the tremendous number of patents which are granted in this country. Patents are allowed for very slight improvements or changes in a device. If the law did not permit persons to obtain patents for slight changes, the number of patents and the consequent litigation would be reduced. Finally, the uncertainty of the law encourages suits. Suits are brought originally in district courts with appeals to the circuit courts of appeal. It is very difficult to bring about uniformity in patent decisions because of the number of district courts and circuit courts of appeal, which not infrequently hand down con-

[45] For a discussion of the suppression of patents, see "Economics of Our Patent System" by Floyd L. Vaughan, Chap. VI.

flicting decisions. The uncertainty which results from this lack of uniformity is bound to encourage litigation.[46]

II. The Registration and Protection of Copyrights.

The constitutional provision which gives to Congress the power to secure to authors and inventors exclusive rights to their writings and discoveries has given rise to a second kind of legislation—namely, that pertaining to copyrights. This legislation goes back to the very beginning of the political history of the United States, to 1790 when the first Federal statute on the subject was enacted.[47] Since that date a number of statutes dealing with this subject have been passed by Congress.[48] The last one, the Act of 1909 with its amendments, is the basis for our copyright law of today.

Since the subject of copyrights has given rise to very little constitutional litigation, any discussion of constitutional questions can be little more than speculation. Perhaps, in the absence of Federal legislation, a state might have the authority to offer protection to artistic and literary productions.[49] Furthermore, the wording of the "patent and copyright clause" seems to impose some limitations upon Congress. This provision declares that in order to promote the progress of *science* and the *useful arts* Congress has the power to secure to *authors* the rights to their writings for limited *periods of time.* From this statement it would appear that copyrights can be granted for limited periods of time only. Furthermore, it would appear that the framers of the Constitution intended that this provision should apply exclusively to the works of authors. If so, their intentions have not been fulfilled, as the statutes permit copyrights for productions of musicians, sculptors, painters, and others who cannot be classed as authors and whose works cannot be classed as writings.

1. *The Subject Matter of a Copyright.* It is difficult to say whether or not the framers of the Constitution intended that

[46] For a detailed account of the evils of patent litigation, see "Economics of Our Patent System" by Floyd L. Vaughan, Chap. VII.

[47] 1 Stat. L. 124–126.

[48] For a list of these statutes, see "History of the Typographical Union" by George A. Tracy, p. 1114.

[49] See the statement in "The Constitutional Law of the United States" by W. W. Willoughby, p. 119.

other classes of persons besides writers should be given copyrights, as this provision was little discussed either during the convention or during the period of ratification. In any case, the Copyright Act has not confined the subject matter of copyrights within the narrow limits expressed in the Consititution. The present law declares that the works for which a copyright can be secured include all of the writings of an author.[50] This provision is followed by a classification of works for purposes of registration. The following things are mentioned: books, periodicals including newspapers, lectures, sermons, public addresses, dramatic compositions, musical compositions, maps, works of art, models or designs for works of art, drawings or plastic works of a scientific or technical character, photographs, prints, pictorial illustrations, and motion pictures.[51]

The term "writing" as used in the act is not confined to bound volumes but applies to writings in almost any form. Such writings may consist of only a page, a paragraph, or even a sentence. It appears, however, that certain blank forms, such as record books, diaries, check books, forms for deeds or leases, index cards, account books, or other similar works whose merit lies in their utility rather than their literary quality may not be the subject of a copyright.[52] The question of whether or not a valid copyright may exist in a trade catalogue has occasionally arisen. It has been held that such a publication containing merely illustrations of products offered for sale together with statements of prices, sizes, and dimensions cannot be copyrighted.[53] On the other hand, if such a production contains some artistic merit or is the result of real intellectual labor, it should receive the protection of the Copyright Law. The question of whether or not reports of court decisions may be copyrighted has come before the courts. The rule appears to be that headnotes, statements of fact, and comments of the publishers may properly be copyrighted but that opinions of the courts may not be.[54]

[50] U. S. Code, Title 17, Sec. 4.

[51] U. S. Code, Title 17, Sec. 5.

[52] See *Bulletin* No. 15 of the Copyright Office, "Rules and Regulations for the Registration of Claims to Copyright," 1926, p. 7; See also 13 Corpus Juris 1022.

[53] Mott Iron Works v. Clow (1897) 82 Fed. 316.

[54] See Callaghan v. Myers (1888) 128 U. S. 617, 32 L. Ed. 547, 9 S. Ct. 177.

The question of the copyright of newspapers and news items has presented itself from time to time. Although the word "newspaper" appears expressly in the statute, such publication cannot be copyrighted in its entirety. A newspaper contains much material, such as a record of current events or other news, which cannot be copyrighted, for such things are not the creation of the writers but mere chronicles of everyday happenings. However, insofar as such accounts have in addition to a narration of current affairs a distinctive style or some literary merit they can be copyrighted.[55] A similar question has appeared in connection with "ticker" quotations. The courts have held that they may not be copyrighted because they are mere electrical notations of current events and are not the result of any creative ability or intellectual labor.[56]

As previously stated, a map is a proper subject for a copyright. Such production, however, must contain some new or original feature and must not be a mere reproduction or copy of some former work.[57]

The term "dramatic composition" appears in the act. Probably not all performances which are produced on the stage fall under this heading. Plays and operas are undoubtedly protected, but what of dances or acrobatic demonstrations? It is very doubtful whether performances of the latter types can be regarded as dramatic compositions within the meaning of that term as used in the statute.[58]

2. *Persons Entitled to Copyrights.* Not all persons desirous of securing protection for their works are entitled to copyrights under the act. Of course the author of the work may secure a copyright. He must be either a citizen of the United States, an alien who is domiciled in this country at the time of publication, or a citizen or the subject of a state which grants to citizens of the United States the benefits of its copyright laws.[59]

Another person entitled to a copyright is the *proprietor.* According to a bulletin of the Copyright Office, the word pro-

[55] Chi. Record-Herald Co. v. Tribune Ass'n (1921) 275 Fed. 797.

[56] Nat'l Tel. News Co. v. Western Union Tel. Co. (1902) 119 Fed. 294.

[57] Woodman v. Lydiard-Peterson Co. (1912) 192 Fed. 67.

[58] For a discussion of this question, see "An Outline of Copyright Law" by Richard C. DeWolf, p. 89.

[59] U. S. Code, Title 17, Secs. 8 and 62.

prietor indicates a person who derives his title to a production from the author.[60]

Finally the executors, administrators, or assignees of the author or proprietor are entitled to a copyright.

3. *The Procedure for Obtaining a Copyright.* The agency responsible for the registration of copyrights is the Copyright Office which is attached to the Library of Congress. The register of copyrights, who is appointed by the librarian of Congress, is in charge of this office.

The procedure for obtaining a copyright varies somewhat depending upon the nature of the production. Certain works, such as books, prints, maps, and periodicals may not be registered until they have been published. A person desiring a copyright must publish and affix to each published copy a notice of copyright. The ordinary form which is prescribed by the Copyright Office is "Copyright, 1928, by John Doe." In the case of maps, photographs, works of art, or similar productions, the notice may consist of the letter "c" enclosed in a circle together with the initials or mark of the author. In this latter case, the name of the author must appear elsewhere on the work. Upon publication, application must be made for registration of the claim in the Copyright Office.[61] This application should be accompanied by two complete copies of the work and the statutory fee.

The procedure is somewhat different for unpublished works, such as lectures, sermons, addresses, dramatic and musical compositions, photographs, works of art, and motion pictures. In addition to the application and the fee, the applicant is required to deposit a copy or photograph, depending upon the nature of the production to be registered. In the case of motion pictures the applicant must send the title, a description of the work, and prints from various parts of the picture.[62]

[60] See Bulletin 15, of the Copyright Office, "Rules and Regulations for the Registration of Claims to Copyright," 1926, p. 6.

[61] U. S. Code, Title 17, Sec. 9.

[62] For the statutory provisions see U. S. Code, Title 17, Secs. 11–12. For an account of the procedure in making application for registration of a copyright claim, see *Bulletin* 15 of the Copyright Office, "Rules and Regulations of the Copyright Office for the Registration of Claims to Copyright," 1926, pp. 9–12.

The statutory fee for registration of most productions is $2, but for some, such as unpublished works or published photographs, the fee is $1.[63]

A copyright lasts for 28 years and may be renewed for another period of 28 years from the date of publication or from the date of deposit in the Copyright Office of a copy of an unpublished work. Not all persons entitled to an original copyright may secure a renewal. The statute gives a right of renewal to the author, the widow or widower, children, executor, or next of kin to the author.[64] It should be noticed that this list does not include an assignee. This means that a publisher who may be entitled to an original copyright for 28 years cannot secure a renewal for a like period of time.[65]

As can be seen from the foregoing description, the procedure in securing the registration of a copyright differs materially from that of obtaining a patent or registration of a trade-mark. No search is made by the Copyright Office to determine whether the applicant is entitled to registration. If the material is of such a nature that it can be copyrighted and if the application is in proper form and contains the required information, the claim will be registered by the office. There are no proceedings such as *interferences*, *oppositions*, or *cancellations*. Since the procedure is so simple, it is unnecessary for an applicant to employ legal talent to aid in securing the registration of a copyright.

A copyright is a species of incorporeal right, a kind of personal property in itself. It is quite distinct from any property right in the material object to which it is attached. It may therefore be assigned, granted, or mortgaged by an instrument in writing or it may be bequeathed by will without at the same time transferring the title to the object to which it is attached. Likewise the object itself may be sold or mortgaged without transferring the copyright. This separability of a copyright from its object is particularly important in the case of a work of art; the author may desire to sell his painting or piece of statuary but retain the copyright. Every assignment of a copyright must be recorded in the Copyright Office within three months. If this is not done,

[63] U. S. Code, Title 17, Sec. 61.

[64] U. S. Code, Title 17, Secs. 23 and 24. See also "An Outline of Copyright Law" by Richard C. DeWolf, pp. 62–67.

[65] See White-Smith Music Pub. Co. v. Goff (1911) 187 Fed. 247.

the assignment is void as against a subsequent purchaser or mortgagee for valuable consideration whose transaction has been duly recorded.[66]

Licensing of a copyright is also a common practice. A license does not, however, transfer the title to a copyright. It merely gives the licensee certain rights to produce, copy, or deliver which he would not otherwise have. Licensing enables the owner of a copyright to split his various rights in such a way as to realize the maximum financial benefit without at the same time disposing of the title to his copyright.

4. *The Rights Granted by the Act.* The provisions of the Copyright Act give to the owner certain very important exclusive rights in his production.[67] In the first place, he has the exclusive right to print, reprint, publish, copy, and sell the work. The words "print" and "reprint" as used here refer not only to the process of printing but also to any form of duplication such as typing, handwriting, reproduction by plates, or other methods. It refers not only to an exact or complete reproduction but also refers to any substantial copy. For example, a district court granted an injunction because the copyright of a musical composition entitled "I Hear You Calling Me" had been infringed by another song which, although entirely different in most parts, contained one similar refrain, "I hear you calling me."[68] The strictness of the rule concerning the copying of another's work is somewhat mitigated by the doctrine of *fair use*, which permits one to make a limited use of the works of another and even to quote extracts for purposes of criticism or illustration.[69] The exclusive right to sell, which is protected by this section, is not very extensive, being limited to the first sale of a production. For example, it was held that the right to sell a copyrighted book did not include the right to impose a limitation on the price at which the book could be resold.[70]

In the second place, a copyright owner is given an exclusive right to translate the copyrighted work into any language or

[66] U. S. Code, Title 17, Secs. 41, 42, and 44.

[67] U. S. Code, Title 17, Sec. 1(a).

[68] Boosey v. Empire Music Co. (1915) 224 Fed. 646.

[69] See "The Law of Property in Intellectual Productions" by E. S. Drone. p. 386.

[70] Bobbs-Merrill Co. v. Strauss (1908) 210 U. S. 339, 52 L. Ed. 1086, 28 S. Ct. 722.

dialect or to make any version thereof. He is given the right to dramatize it or, if it is a drama, to convert it into a novel or other nondramatic work. If it is a musical work, he may arrange or adapt it to uses other than the original.[71] A word of explanation is necessary concerning some of these rights. The right to dramatize includes the right to produce and exhibit a work in the form of a motion picture.[72] The right of arrangement or adaptation of music includes the right of making phonograph records, rolls for mechanical pianos, or other similar methods of reproducing sound. A word should be said concerning the term, "to make any version thereof." In one case the court held that a book entitled "Opera Stories," which merely gave a synopsis of the plot and a brief description of the scenes and characters, was not a "version" of the copyrighted work within the meaning of that term as used in the statute.[73] The court pointed out that to construe literally the words "to make any version thereof" would not only make it illegal to publish a book but also to publish any newspaper review of the performance, even though the reviewer or critic had been invited to attend and witness the production.

One of the most important rights which an owner of a copyright enjoys is that of *performance*.[74] The statute gives to a person entitled to a copyright the right to deliver a lecture, sermon, or other similar production in public for a profit. If the work is a *drama*, the exclusive right is given to perform, exhibit, represent, produce, or reproduce it publicly in any manner whatsoever. This right is so extensive that any public performance without the consent of the copyright owner violates the statute. It is obvious that this section of the act is violated frequently by the numerous amateur theatrical groups which produce plays without the consent of the owner. Such groups do not realize, in all probability, that their action constitutes a violation of the Federal statute. On this point an authority on the subject of copyrights declares:

> Public performance is performance in any place to which the public is admitted without restriction, whether admission is charged or not.

[71] U. S. Code, Title 17, Sec. 1(b).

[72] Kalem Co. v. Harper Bros. (1911) 222 U. S. 55, 56 L. Ed. 92, 32 S. Ct. 20.

[73] Ricordi and Co. v. Mason (1913) 210 Fed. 277, *affg*, 201 Fed. 184.

[74] U. S. Code, Title 17, Sec. 1(c)(d)(e).

Reference may be made here to the practice among amateur dramatic companies of performing any play of which copies can be obtained, on the easy assumption that no harm is done if no charge is made, or if profits of the performance go to some charitable purpose. Both the idea and the practice are wrong and such performances are none the less infringements.[75]

Also, the act protects the owner of a copyright in the performance of *musical compositions* by providing that he has the exclusive right to their public performance for a profit. It should be noted that mere unauthorized public performance without a profit does not violate this right. In construing this provision the courts have handed down some interesting decisions. In the case of *Herbert v. Shanley* certain copyrighted music had been played in a public café without the consent of the copyright owner, and the Supreme Court of the United States decided that this was performance for a profit.[76] The case was interesting because the music was only an incidental and indirect source of revenue. The court pointed out, however, that if musical copyrights were infringed only in cases in which money was actually collected at the door, the owners would be imperfectly protected.

Radio broadcasting and reception have caused the courts some trouble in their efforts to determine what constitutes performance for a profit within the meaning of the Copyright Act. There should be little difficulty in bringing radio broadcasting within the decision of the court in *Herbert v. Shanley.* Radio reception presents more complications, however. Obviously the owner of a private radio set who invites guests to his home to listen to a musical program would not be liable for an infringement of a copyright, because such reception is neither public nor for a profit. Nevertheless, under some circumstances radio reception, if unauthorized, constitutes a violation of this provision of the act. In the case of *Buck v. Jewell-LaSalle Realty Company* suit was brought by the American Society of Composers, Authors, and Publishers against the operators of a hotel in Kansas City. The hotel had a master radio receiving set which was

[75] See "An Outline of Copyright Law" by Richard C. DeWolf, p. 107. Quotation printed by courtesy of John W. Luce and Co., publishers.

[76] Herbert v. Shanley Co. (1917) 242 U. S. 591, 61 L. Ed. 511, 37 S. Ct. 232.

wired to each room so that the guests might have radio entertainment if they so desired. Certain copyrighted works were broadcasted and relayed by the hotel to various rooms. Suit was brought for infringement. A Federal district court denied relief and the circuit court of appeals in reviewing the case certified to the Supreme Court the question of whether the acts of the hotel keeper constituted performance within the meaning of the Copyright Act. The Supreme Court answered in the affirmative and pointed out that reception of broadcasting and its translation into sound was not the equivalent of mere audition but was original production and that, when radio waves were transmitted and could not be heard directly but had to be changed, the conversion which took place in the receiving set was production or performance within the meaning of the law.[77]

5. *Remedies for Infringement.* The act gives a number of remedies to persons whose copyrights have been infringed. In the first place, it is possible to secure an injunction. In addition, a person who has infringed the copyright of another is liable for damages, not only the damages which the plaintiff has suffered but also the profits which have been made as the result of the infringement. The statute fixes varying maximum and minimum amounts which may be assessed as damages for the infringement of certain kinds of productions. The law provides, also, for the impounding during litigation of all articles alleged to infringe the copyright. Finally, copies or plates which are involved in the infringement may be ordered destroyed by the court.[78]

Under some circumstances criminal liability may be incurred by violators of the Copyright Act. Persons who willfully and for a profit infringe a copyright are guilty of a misdemeanor and may be fined $100 to $1000, imprisoned for one year or less, or subjected to both fine and imprisonment.[79]

6. *Registration of Prints and Labels.* Provision is made for the registration of prints and labels which are used for articles of manufacture. Although such registration is made in conformity with regulations provided for the copyright of ordinary prints, the control and supervision of such registration has been

[77] Buck v. Jewell-LaSalle Realty Co. (1930) 283 U. S. 191, 75 L. Ed. 971, 51 S. Ct. 410.

[78] U. S. Code, Title 17, Sec. 25.

[79] U. S. Code, Title 17, Sec. 28.

entrusted, not to the register of copyrights, but to the commissioner of patents. The fee for registering such prints and labels is $6.[80]

7. *Proposed Changes in the Copyright Act.* During the past few years a number of changes in the copyright laws have been proposed. One of the most important of these would make the United States a member of the so-called International Copyright Union. This union was established at Berne, Switzerland, in 1886 and was revised at Berlin in 1908. The principal purpose of the union is to give to authors international protection for their works. Authors within the jurisdiction of a country which is a member of this union are entitled to the rights which other member countries of the union grant to their natives.[81] At present, authors whose works are copyrighted in the United States can receive protection abroad only under treaty provision or some other special arrangement.

Another proposed change would extend the duration of a copyright either for the life of an author plus a period of 50 years or would permit an original copyright for 60 or 70 years.

A third suggested alteration would provide for the automatic copyright of a work upon its completion. At present, in order to secure a copyright of a published work, it is necessary to publish the work, affix notice of a copyright, and make application for registration.

It has been proposed also to add some provisions concerning the divisibility of copyrights. There are many rights to which the owner of a copyright is entitled, such as the right to publish, dramatize, reproduce, etc. The owner may wish to sell one but not all of these. Under the present act, however, provisions for division of rights are unsatisfactory. One proposed law provides that the owner of a copyright may sell, assign, or mortgage the entire copyright or any rights therein with such limitations as may be agreed upon.[82]

[80] U. S. Code, Title 17, Sec. 63.

[81] For the provisions of this convention see "An Outline of Copyright Law" by Richard C. DeWolf, p. 299.

For a brief discussion of the convention see "The Law Relating to Authors and Publishers" by B. M. Cloutman and Francis W. Luck, p. 90.

[82] The Annual Report of the Register of Copyrights for 1931 discusses some of the proposed statutory changes in full. This same report contains discussion and comments on these proposals.

Finally, proposals have been made for the registration with the Copyright Office of designs for fabrics, wallpaper, china, carpets, and other commercial articles. It has been asserted that the protection for designs afforded by the patent laws is by no means adequate to protect manufacturers from design pirates. In the first place, many of these designs have transitory value only. The procedure through the Patent Office is so slow and tedious that many manufacturers do not find it worth while to make the effort to secure a design patent. Moreover, to secure protection under the patent laws, a design must be new and original. The great majority of industrial designs do not meet this requirement. These suggestions for the protection of designs represent a radical departure from the theory of previous copyright legislation. Heretofore, laws have protected productions which have supposedly had some literary or artistic merit. If the proposed change is enacted, the Copyright Law will afford protection to designs whose chief value is commercial.

III. The Registration and Protection of Trade-marks.

As has been previously stated, the power of Congress to enact trade-mark legislation is derived from the commerce clause of the Constitution.[83]

Even before the enactment of trade-mark statutes, persons were protected in equity by injunctions against the false use of trade names.[84] The first Federal statute on the subject of trade-marks was an Act of 1870. This provided that any firm, person, or corporation who was entitled to the exclusive use of any lawful trade-mark or who intended to adopt and use any trade-mark exclusively within the United States could obtain protection for such mark by recording it in the Patent Office and paying the required fee.[85]

[83] For a definition of a trade-mark see "A Treatise on the Law of Trade-marks" by Francis H. Upton.

In the case of the Elgin National Watch Co. v. Ill. Watch Case Co. (1901) 179 U. S. 665, 45 L. Ed. 365, 21 S. Ct. 270 the Supreme Court stated, "The term has been in use from a very early date, and, generally speaking, means a distinctive mark of authenticity, through which the products of particular manufacturers . . . may be distinguished from those of others."

See also "The Law of Unfair Competition and Trade-marks" by Harry D. Nims, Chap. XIII, p. 502.

[84] See "A Short History of English Law" by Edward Jenks, p. 290.

[85] U. S. Revised Statutes, Sec. 4937.

In the well-known *Trade-mark Cases* the question arose as to the possible constitutional sources from which Congress derived the power to enact this legislation.[86] Two possible sources were suggested, the "patent and copyright clause" and the "commerce clause." The Supreme Court pointed out that the authority of Congress could not be derived from the "patent and copyright clause" because a trade-mark had nothing to do with invention, discovery, or writing. The right to its registration was not founded upon novelty, discovery, or work of the brain but largely upon priority of appropriation of the mark to particular goods or products. Any device, even though it was simple or well-known, might be registered if first appropriated as a distinctive mark. Furthermore, the Supreme Court could not find authority in the commerce clause of the Constitution to enact the Trade-mark Act of 1870. Under the "commerce clause" Congress had been given the power to regulate, not all commerce, but commerce among the states, with foreign nations, and with the Indian tribes. In enacting the Trade-mark Act of 1870, however, Congress had not limited its application to interstate and foreign commerce but had passed an all-inclusive and comprehensive statute.

Following the decision of the Supreme Court in the *Trade-mark Cases* Congress enacted the Trade-mark Act of 1881. The Act of 1881 was largely supplanted by the Trade-mark Act of 1905, which with the Trade-mark Act of 1920 forms the backbone of the Federal law on the subject today. Although the Supreme Court has not definitely passed upon the constitutionality of these statutes, presumably they are constitutional. They have been enacted under the commerce clause of the Constitution. Congress has confined their scope to foreign and interstate commerce. Such marks are usually attached to and closely identified with goods and products which are bought, sold, and transported. They are a very important and in fact an almost indispensable part of such traffic. Therefore it may be fairly assumed that Congress has the constitutional authority to protect a vital and important part of interstate commerce.

Congress has made no attempt to define trade-marks, create property rights therein, or to cover the substantive law of trade-marks but has merely provided for a system of registration and

[86] The Trade-mark Cases (1879) 100 U. S. 82, 25 L. Ed. 550.

protection. The extent to which a person is protected under the present acts has received some consideration in a decision of the United States Supreme Court. The plaintiff in this case had a trade-mark "Home Brand" which had been registered in the United States Patent Office and had been used on certain food products sold in Minnesota and the neighboring states. The defendant had been selling products similar to those manufactured by the plaintiff, and had been using a label with the word "Home" thereon. These labels were used by companies in states other than those in which the plaintiff had established a market. An injunction was sought against the defendant. The Supreme Court held that there was no remedy for infringement since the actions of the defendant did not affect or interfere with the interstate commerce of the plaintiff. The court indicated in this case that, even though a trade-mark is registered in the Patent Office under the Federal act, there must be evidence that there has been some interference with its use in foreign or interstate commerce before it will be protected.[87] There has been some discussion over the question of whether or not Congress has the power to legislate on the substantive law of trade-marks. The supreme Court has stated that Congress has no such authority.[88] It is difficult to see, however, why there should be any constitutional barrier. Insofar as substantive legislation would protect or promote interstate and foreign commerce, it should be constitutional.

Since the Federal government has not exercised and probably cannot exercise exclusive authority over the registration, use, and protection of all trade-marks, a great part of the field is open for state control. Many states have statutes providing for the registration and protection of trade-marks.[89] The exact line of demarcation between Federal control and that of the states is difficult to draw as the courts have had little occasion to pass on the question. It would seem that registration and protection of trade-marks is a matter for the states where such

[87] U. S. Printing and Lithograph Co. v. Griggs Cooper and Co. (1929) 279 U. S. 156, 73 L. Ed. 650, 49 S. Ct. 267.

[88] American Trading Co. v. Heacock Co. (1932) 285 U. S. 247, 76 L. Ed. 740, 52 S. Ct. 387. See the discussion of this question in the *U. S. Daily*, Feb. 9, 1932, p. 1.

[89] See for example, Code of Iowa, 1935, Secs. 9867–9874.

marks are used in connection with goods moving solely in intrastate commerce or used in connection with businesses which are not commerce.

1. *The Registration of Trade-marks under the Act of* 1905. Application for registration of trade-marks may be made under the Act of 1905 or under the Act of 1920. There are some differences in the nature of the marks which may be registered, in the procedure for registration, and in the effect of registration under each of these acts. The differences should be carefully noted.[90]

The Act of 1905 provides that the owner of a trade-mark used in commerce with foreign nations, among the several states, or with the Indian tribes may obtain registration of such mark.[91] It should be noted that the act makes no provision for the registration of trade-marks which are used only in connection with services such as those rendered by insurance companies, banks, collection agencies, laundries, and taxicabs.[92]

Even all trade-marks used in connection with merchandise shipped in interstate and foreign commerce cannot be registered under the Act of 1905. Section 5 contains a number of important limitations.[93] In the first place, registration cannot be obtained for a mark which consists of immoral or scandalous material. This provision is merely a limited expression of the broader common-law rule that no mark shall be contrary to public policy.

A second limitation is placed upon the registration of trade-marks by the provision that no mark may be registered which consists of the flag, coat of arms, insignia of the United States, state, municipality, or any foreign nation, or any simulation thereof; any design or picture which has been adopted or may hereafter be adopted as the emblem of any fraternal society; any name or distinguishing mark, emblem, color, flag, or banner which has been adopted by any institution, organization, club, or society incorporated in any state of the United States prior

[90] For a statement of the differences between the Act of 1905 and that of 1920 see the article in 11 *American Bar Association Journal* 461, "Trade-marks and the Patent Office" by Karl Fenning. See also the summary in Fitzpatrick Bros. v. Heller and Co. (1925) 341 O. G. 257.

[91] U. S. Code, Title 15, Sec. 81.

[92] See pamphlet put out by the Patent Office, entitled "General Information about Protection of Trade-marks, Prints and Labels," p. 4.

[93] U. S. Code, Title 15, Sec. 85.

to the date of the adoption and the use of the mark by persons seeking its registration.

Furthermore, Section 5 forbids the registration of a trade-mark which is identical with a registered or known trade-mark owned and used by another or which so nearly resembles such mark as to be likely to cause confusion in the minds of the public and which is appropriated to merchandise of the same descriptive qualities. Two questions are raised by the wording of this provision: (1) When is a mark so similar as likely to cause confusion? (2) What is meant by the phrase "appropriated to merchandise of the same descriptive properties"?

Corporations or individuals have often sought to profit from the reputation of a rival firm by adopting and seeking to register similar trade-marks. The purpose is to cause confusion in the minds of the public. Sometimes this confusion arises from similarity of color; sometimes it results from similarity of design; often it comes from a mere similarity in the words which an applicant seeks to register. For example, a certain flour company had used the word "Ceresota" and another company tried unsuccessfully to register the word "Certosa."[94] The words "Lucky Lindy" were held not registerable as a trade-mark for use in connection with cigarettes because of the probability of confusion with the mark "Lucky Strikes" which had been registered.[95] In another case the Court of Customs and Patent Appeals held that the mark "Zip-On" was confusingly similar to the registered trade-mark "Zipper," and therefore its registration should be cancelled.[96]

There has been much uncertainty as to the meaning of the phrase "appropriated to merchandise of the same descriptive properties." At first sight this seems to refer to marks which are used on goods that are identical. From a reading of the context, however, it can be seen that this phrase is intended to prevent confusion or mistake which may result in the minds of the public. Obviously where the trade-marks are used with goods as different as silverware and spools of thread, little confusion is likely to arise. However, where there is some real similarity in the goods

[94] See N. W. Consolidated Milling Co. v. Callam (1910) 177 Fed. 786.

[95] American Tobacco Co. v. Materezzo, opinion by first assistant commissioner of patents, reported in *U. S. Daily*, Sept. 30, 1929, p. 8.

[96] Goodrich Co. v. Hockmeyer (1930) 40 Fed. 2d 99.

either in their form, composition, texture, or quality, or even in the uses to which they are put or the manner in which they are dressed, this provision should be interpreted broadly enough to prevent confusion. In one case the Court of Customs and Patent Appeals upheld the right of the owner of the trade-mark, "Del Monte," which had been used on certain canned fruits and vegetables, to oppose the registration of this mark for coffee. According to the court, one-pound cans of coffee on the same shelves with 150 other kinds of canned products on which identical trade-marks were used would cause confusion and lead the public to believe that the coffee was the product of the Del Monte Company.[97]

In another case the Court of Customs and Patent Appeals held that collar buttons constituted goods of the same descriptive properties as shirts and collars. The court pointed out that a purchaser of these goods would be very apt to think that the collar buttons were made by the company which made the shirts and collars.[98] The Patent Office has made a classification of articles for purposes of trade-mark registration.[99] That articles are in different classifications is a factor but is not conclusive proof in determining whether or not goods have the same descriptive properties within the meaning of the statute.[100]

A trade-mark which consists merely of the name of an individual, firm, corporation, or association cannot be registered under the Act of 1905 unless it is printed or written in some distinctive manner or used in connection with the portrait of an individual. Thus, for example, an applicant sought to register the words "Deacon Brown," but the court held that such a mark was not distinctive enough to permit registration. The court pointed out that the word "Brown" standing alone could not be registered and that the mere addition of the word deacon

[97] California Packing Co. v. Tillman and Bendel (1930) 40 Fed. 2d 108.

[98] Cluett Peabody and Company Inc. v. Hartogensis (1930) 41 Fed. 2d 94.

[99] For this classification see the pamphlet put out by the Patent Office, "General Information about Protection of Trade-marks Prints and Labels," p. 22. See also "Patents Trade-marks and Copyrights" by Oscar Geier, p. 95.

[100] See the statement of the assistant commissioner of patents in the case of Chamberlain Co. v. Chase and Sanborn, Opposition No. 8801, reported in *U. S. Daily*, April 27, 1929, p. 8.

made the mark no more distinctive than adding general, doctor, or mister.[101] A diamond, circle, square, or other similar outline when used with a name in ordinary printing or writing is not distinctive enough to make the mark registerable.[102]

No mere geographical name can be registered under the Trade-mark Act of 1905. The object of this limitation is to prevent the exclusive appropriation of words to the goods of one person or firm which other persons should be allowed with equal justice to use. For example, if three companies make flour in Chicago, no one of them should have the exclusive right to use the words "Chicago Flour Company." Many cases involving attempts to register geographical names have come before the courts and the tribunals of the Patent Office. In one case it was held that the name "Pullman" was not registerable because it was both the name of an individual and the name of a place.[103] In another case it was held that the term "Old Virginia" was a geographical word and therefore could not be registered.[104] On the other hand, geographical expressions can sometimes be registered under this act. Such is the case with words which are used not to designate the place of manufacture but which are merely fanciful terms arbitrarily used in order to designate the goods of a manufacturer. Thus the mark "American Girl" used in connection with shoes was held to be registerable since it was fanciful and did not designate the place of manufacture.[105] Using this same line of reasoning, the Patent Office decided that there was no objection to the registration of the words "New Yorker" to be used as a trade-mark for shirts.[106]

Section 5 of the Act of 1905 prohibits the registration of words or devices which are merely descriptive of the character or quality of the goods to which they are appropriated.[107] The reason for

[101] *In re* Artesian Mfg. Co. (1911) 37 App. Cases 113.

[102] See the statement of the first assistant commissioner of patents in *Ex parte* Marsh (1929) 382 O. G. 845.

[103] *Ex parte* White Co. (1929) 386 O. G. 5.

[104] *Ex parte* Samuel Cabot (1919) 263 O. G. 633.

[105] Hamilton Brown Shoe Co. v. Wolf Bros. and Co. (1916) 240 U. S. 251, 60 L. Ed. 629, 36 S. Ct. 269.

[106] *Ex parte* Levin and Harris Shirt Co., Opinion reported in *U. S. Daily*, Nov. 19, 1928, p. 8.

[107] For a list of words which have been refused registration because they were descriptive of quality of the goods, see "The Law of Unfair Competition and Trade-marks" by Harry D. Nims, p. 631.

this rule is obvious. Any person whose goods have the same qualities should have the right to make use of descriptive words. Many interesting cases have arisen as a result of this provision of the act. For example, it was held that the mark "No Sag" used in connection with hand bags could not be registered because it was descriptive.[108] For the same reason the term "self-loading" as applied to cartridges was held not registerable.[109] On the other hand, it is possible to register as a trade-mark words which in some way designate the qualities of the goods if they are fanciful or suggestive rather than descriptive. The addition of a suffix, prefix, or another word or words which standing alone would be descriptive will often suffice to make an expression registerable. Thus the Court of Appeals of the District of Columbia declared that the terms "Dainty Maid" and "Lady Dainty" as applied to hosiery were not descriptive, even though the word "dainty" standing alone would undoubtedly be unregisterable.[110] In another case the same court pointed out that the words butter or honey standing alone would undoubtedly be descriptive when applied to candy, yet when joined with a suffix so as to make the words "Honeymels" or "Buttermels" the expression became merely suggestive and not descriptive.[111] A mere misspelling of a word will not take a mark out of the descriptive category. Thus, it was held that the word "Hicycle" was a mere misspelling of high cycle and could not be registered because it was merely descriptive of certain electrically operated tools.[112]

Finally, it should be mentioned that the portrait of a living individual cannot be registered without the consent of such individual. Nor may the portrait of any deceased president of the United States be registered during the life of his widow without her consent.

2. *Registration of Trade-marks under the Act of* 1920. The Trade-mark Act of 1920 has made possible the registration of many trade-marks which could not be registered under the Act

[108] *In re* Freund Bros. and Co. (1911) 37 App. Cases 109.

[109] Winchester Repeating Arms Co. v. Peters Cartridge Co. (1908) 30 App. Cases 505.

[110] McLellan Stores Co. v. Conrad and Co. (1927) 18 Fed. 2d 826.

[111] Switzer v. Collins Co. (1927) 23 Fed. 2d 775.

[112] Chicago Pneumatic Tool Co. v. Black and Decker Mfg. Co. (1930) 39 Fed. 2d 684.

of 1905: namely, marks which have geographical significance, which are descriptive, or which consist of the name of an individual or corporation. Apparently one of the purposes of this act was to give a basis for registration in foreign countries of such marks. Certain countries had the rule that trade-marks could not be registered abroad which were not registered in the Patent Office.

The Act of 1920 states that the commissioner of patents shall keep a register of all trade-marks which are not registerable under the Act of 1905 and which have been in *bona fide* use in interstate or foreign commerce for one year.[113] In spite of the wide scope of the Act of 1920, it does not permit the registration of all trade-marks. If a trade-mark is immoral or scandalous, embodies the flag or some symbol of the United States, state, unit of local government, or some society, or is identical with or very similar to a trade-mark already registered or in use upon goods of the same descriptive properties, it cannot be registered even under the Act of 1920. A trade-mark cannot be registered under the Act of 1920 if it is possible to register it under the Act of 1905.[114]

3. *Procedure for Registration.* A person who is desirous of securing the registration of a trade-mark is required to file with the Patent Office an application in writing addressed to the commissioner of patents. This application must be signed by the applicant and specify his domicile, location, and citizenship; it must state the class of and give a description of the merchandise to which the mark is attached; it must state the manner in which the mark is affixed to such goods; and it must specify the length of time during which the mark has been in use. A drawing of the trade-mark, five specimens of the mark as actually used, and a fee of $15 must accompany the application.[115]

The application is then turned over to an examiner, who makes a search to determine whether or not it is in proper form, whether or not it is of a registerable character, and whether or not it conflicts with the trade-mark of some other person. If any defect is found, the applicant may contest or amend so as to

[113] U. S. Code, Title 15, Sec. 121 as amended by Public Act No. 568, 75th Congress, 3d Session, approved June 10, 1938.

[114] See "The Law of Unfair Competition and Trade-marks" by Harry D. Nims, Chap. XVI, p. 597.

[115] U. S. Code, Title 15, Sec. 81.

meet the objection. If the application is approved, the owner is notified and the mark is published in the *Official Gazette* of the United States Patent Office.[116] Within 30 days after publication, any person who feels that he would be injured by the registration may file what is called an *opposition*. A hearing is then held to determine the right of registration.[117]

If a mark which an applicant seeks to register closely resembles that of a trade-mark already registered or one for which an application to register has been made, and if the marks are appropriated to goods of the same descriptive properties so that in the opinion of the commissioner of patents the public is likely to be confused, the commissioner may declare that an *interference* exists. A hearing is then held to determine the right of registration.[118]

After a trade-mark has been registered, it is possible for a person who believes himself injured by the registration to institute *cancellation proceedings* in the Patent Office.[119]

Appeals are permitted from decisions in trade-mark cases. Applicants whose marks have been refused registration or parties to proceedings for opposition, interference, or cancellation may appeal to the commissioner of patents, and from his decision an appeal may be taken to the Court of Customs and Patent Appeals.[120]

Although under the Act of 1920 there are no provisions for oppositions or interferences, cancellation proceedings may be instituted.[121] However, in cancellation proceedings under the Act of 1920 there is no provision for appeals from decisions of the Patent Office to the Court of Customs and Patent Appeals.[122]

Registration under the Act of 1905 lasts for a period of 20 years and may be renewed for like periods of time.[123] There is no time limit for the duration of registration under the Act of 1920.

[116] See the pamphlet put out by the Patent Office, "General Information about Protection of Trade-marks Prints and Labels," revised to Apr. 1, 1928, p. 7.

[117] U. S. Code, Title 15, Sec. 86.

[118] U. S. Code, Title 15, Sec. 87.

[119] U. S. Code, Title 15, Sec. 93.

[120] U. S. Code, Title 15, Secs. 88–89.

[121] U. S. Code, Title 15, Sec. 122.

[122] See U. S. v. Compression Inner Tube Co. (1923) 53 App. Cases 370.

[123] U. S. Code, Title 15, Sec. 92.

After a trade-mark has been registered, the following notice should appear when the mark is used, "Registered in U. S. Patent Office" or "Reg. U. S. Pat. Off." If a party fails to affix this notice, no damages can be recovered except upon proof that the defendant was duly notified and continued the infringement.[124]

4. *Protection to Trade-marks.* It should be remembered that registration of a trade-mark under the Federal act does not create the trade-mark, it does not confer any title upon the owner, nor is it essential to the validity of such mark. Trade-marks are acquired by use. It should be remembered also that the Federal statutes do not take away any common-law, equitable, or statutory right or remedy which a party may have under state laws but merely provide some additional advantages and remedies.

What are the advantages of registration of trade-marks with the Patent Office? In the first place, under the Act of 1905 a certificate of registration of a trade-mark is *prima facie* evidence of ownership.[125] However, the Act of 1920 does not accord this to registrations which are made under its provisions.[126] In addition, Federal registration gives to the owner of a registered trade-mark a right to sue for damages or for an injunction in the Federal courts. Without Federal registration it would be impossible for a plaintiff to use the Federal courts unless the defendant were a citizen of another state. The right to sue in the Federal judiciary is advantageous in that a court may enter judgment for any sum up to three times the amount of damages incurred and may order the destruction of the offending labels. Furthermore, upon complying with certain regulations of the Treasury Department and filing a certified copy of a registered trade-mark with the collector of customs, the importation of any goods bearing a copy or imitation of a registered mark will not be permitted.[127] Finally, in many countries registration of an American trade-mark is not allowed unless it is registered in the United States Patent Office.[128]

[124] U. S. Code, Title 15, Sec. 107.

[125] U. S. Code, Title 15, Sec. 96.

[126] Chas. Broadway Rouss Inc. v. Winchester Co. (1924) 300 Fed. 706.

[127] U. S. Code, Title 15, Secs. 96–110.

[128] For a brief statement of the advantages of Federal registration see "Trade-marks" by Clowry Chapman, p. 58.

5. *State Registration and Protection of Trade-marks.* The power to provide for the registration and protection of trade-marks is shared by both Federal and state governments. The registration and protection of marks which are used in interstate commerce has been undertaken by the Federal government; whereas the states have provided for registration of marks used in intrastate commerce.

State laws frequently contain a definition of a trade-mark. The Tennessee statute defines a trade-mark as any seal, label, term, design, device, or form of advertisement used for the purpose of designating any goods, wares, merchandise, or other product of labor as having been made or put on sale by any person.[129]

Most of the state laws provide for the registration of trade-marks with the secretary of state and prohibit any person from counterfeiting or imitating trade-marks.[130]

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CHAPTER XXIII

GOVERNMENT AID TO BUSINESS

One of the interesting features of the relationship of government to business is the aid which is offered to commerce and industry by numerous governmental boards, bureaus, and commissions. Although state and local governments occasionally furnish aid to business, the Federal government is a far greater benefactor. Much of this aid, such as the issuance of patents, the registration of trade-marks and copyrights, the sponsoring of trade practice conferences, and the cooperation with the aeronautics industry, has already been discussed in previous chapters. But these by no means exhaust the illustrations of assistance which the government of the United States offers to business. Few governments in the world conduct so many experiments and gather so much information of value to the commerce and industry of their citizens as does the United States. The Federal government not only gathers information and conducts experiments, but it also gives more direct aid, sometimes by loans of money to business and sometimes by direct subsidies.

I. Aid to Foreign and Domestic Commerce.

The chief agencies through which the Federal government seeks to furnish assistance to persons engaged in foreign commerce are the Bureau of Foreign and Domestic Commerce and the Consular Service. At one time these two branches of the government worked separately, but recently they have cooperated in their efforts to aid and stimulate foreign commerce. One of their chief services is the collection and distribution of information concerning markets for American goods. Another is that of placing foreign companies in touch with American commodities and firms. Another service is the protection of American trade-marks and patents in foreign countries. American officials gather information concerning the procedure which is

necessary to register trade-marks or to secure patents abroad and report cases of infringement which come to their attention. Other services are the adjustment of trade disputes between foreign and United States companies and the collection and distribution of valuable information concerning foreign-trade laws, commercial treaties, tariff restrictions, and other similar subjects.[1] For the year ending June, 1931 the Bureau of Foreign and Domestic Commerce estimated that as a result of its efforts American firms received new foreign trade and effected savings the value of which approximated $57,000,000.[2]

The first appropriation to the bureau for work to aid domestic commerce was made for the year ending June, 1924. The Bureau of Foreign and Domestic Commerce collects, analyzes, and disseminates much information which it believes to be of value to persons engaged in commerce and industry. The bureau makes studies of merchandising costs, credits, sales efforts, consumers' preferences, industrial marketing, and other subjects. Also it makes trade-area studies, commodity-movement studies, and other investigations having regional significance. In addition to its offices in Washington the Bureau of Foreign and Domestic Commerce maintains district offices in certain cities throughout the United States.[3]

II. Aid to Commerce and Industry by Experimentation and Standardization.

Perhaps no bureau of the Federal government conducts more experiments or gathers more information of value to business than does the Bureau of Standards. This great research laboratory conducts a vast number of experiments and makes a large number of tests of great industrial and commercial significance. Some of these are undertaken in order to further other activities of the bureau and others are performed for various branches of the Federal government, for the states, for municipalities, and for private parties. These tests and analyses cover a great

[1] For an account of these activities of the bureau see "Bureau of Foreign and Domestic Commerce," Service Monograph of the U. S. Govt., No. 29, pp. 43–62, prepared by the Institute for Govt. Research.

[2] See Annual Report of the Bureau of Foreign and Domestic Commerce, 1931, p. 11.

[3] See Annual Report of the Director of the Bureau of Foreign and Domestic Commerce, 1931, p. 7.

variety of fields. Some of them are chemical analyses of various products; others are tests of heat and power; still others are experiments with electricity; and some are experiments with many kinds of materials, such as rubber, paper, leather, and textiles.[4] A few of the tests of the Bureau of Standards have had considerable commercial significance. For example, as a result of its experiments in producing a hard, refined, and cheap sugar from corn, a new industry was developed in the United States.[5]

The Bureau of Standards performs certain services which are designed to be beneficial to those interested in building and housing. It has, for example, conducted investigations on the resistance of various materials to fire. Obviously such information is valuable to insurance companies or to towns and cities as a guide in the formulation of a scientific building code. The bureau has taken an active interest in the problem of zoning. It has published a zoning primer and a standard state zoning enabling act which are intended to be of value to legislators and city officials.

The effort of the bureau to bring about a more extensive use of standard specifications has attracted much attention. Work of this sort is of interest to both consumers and producers. Ordering by specification simplifies transactions for large producers and consumers since they can merely refer to a specification instead of giving or requiring a detailed description of the goods which they buy and sell. Where no standard exists, buyers and sellers of large quantities of particular commodities must make their own specifications. For the small consumer, a specification means that he is reasonably certain of getting a product which will perform the task for which it is intended. The Bureau of Standards has investigated the private agencies which exist for promoting the use of specifications, has called to their attention the work of the bureau, and has sought to cooperate with them in the establishment of specifications. The

[4] Some idea of the extent of this experimental work can be gathered from the diagram of the subdivisions of the Bureau of Standards found opposite p. 1 of the Annual Report of the Director of the Bureau of Standards, 1931. For a brief discussion of the work of some of these subdivisions, see "Federal Departmental Organization and Practice" by G. C. Thorpe, pp. 473–487.

[5] See the report of the speech by Geo. K. Burgess in *U. S. Daily*, Mar. 28, 1929, p. 10.

bureau stands ready to assist in every attempt to change from a hit-and-miss method of specification to methods which are logical and general. It has issued a list of manufacturers who have expressed a willingness to supply material in accordance with certain Federal specifications or commercial standards and who have asserted a willingness to certify to purchasers that certain goods comply with the specifications. The Bureau of Standards, however, assumes no responsibility in connection with such specifications. Any failure to come up to a standard which is called for must be dealt with through a court or other agency having jurisdiction.[6]

Another important work closely allied to that of specifications is the establishment of commercial standards for grades and qualities of products. The Federal government does not take the initiative in the establishment of a commercial standard but merely places its machinery at the disposal of groups which are eager to set up a standard. When a specific request is received for the services of the bureau from some industry or trade group, a preliminary canvass is made to ascertain whether or not the industry is interested in the proposal. If the response is favorable, a conference is called and recommendations for standards are submitted. The recommendations for standards are sent to each unit of the industry. If about 65 per cent of the members of an industry approve, the standard is then published as a commercial standard.[7]

Another work closely related to commercial standards is that of establishing simplified practices. By securing a reduction of the number of sizes or kinds of commodities, the Bureau of Foreign and Domestic Commerce seeks to reduce the wastes in commerce which result from the lack of uniformity in types and sizes or from the use of obsolete products. The procedure here is very much the same as in the case of the establishment of a commercial standard. The initiative and success rest almost entirely with particular industries or trade groups. The bureau

[6] See the following pamphlets and circulars of the Bureau of Standards: "Certification Plan: Significance and Scope," Miscellaneous Publication No. 105, 1930. "Letter Circular No. 277," 1930. "Letter Circular No. 256a," 1930.

See also the article by A. S. McAllister in *U. S. Daily*, Oct. 8, 1928, p. 9.

[7] See the article by I. G. Fairchild, in *U. S. Daily*, Oct. 4, 1928, p. 9.

merely offers its services to aid in any cooperative effort.[8] There are many instances of the adoption of simplified practices as a result of the efforts of the Bureau of Standards. For example, agreements were made to reduce the number of sizes and styles of paving bricks from 66 to 5, bed blankets from 78 to 12, hot-water storage tanks from 120 to 14, and milk bottles from 49 to 9.[9]

III. Aid to Business through the Collection and Publication of Statistics.

The Bureau of the Census, which is located in the Department of Commerce, is probably the greatest statistical collecting agency in the world. Although the average person conceives of this bureau merely as the agency which takes the regular census every ten years, its activities are far more extensive. For example, every two years it takes a census of manufacturers; every five years it takes a census of electric light and power plants, electric railways, and telephone and telegraph systems.[10] The bureau publishes a large number of statistical reports of value to commerce and industry. The Annual Report of the Director of the Census for 1927 stated that during the previous year the bureau issued 2,106 such reports on current business.[11] The bureau issues a monthly publication called the *Survey of Current Business.* With the increase in the use of statistics by business and a greater realization of their value, the importance to commerce and industry of the work of this bureau has increased.

The Bureau of Labor Statistics is required by law to collect and publish at least once each month full and complete statistics concerning the volume and changes in employment of workers as indicated by the number of persons employed, the total hours of employment, and the total wages of persons employed in the government and in manufacturing, mining, quarrying, oil production, building, agriculture, lumbering, transportation, public utilities, retail and wholesale trade, and such other occupations

[8] For an account of this procedure, see the Standards Year Book, 1930, p. 7, published by the Department of Commerce.

[9] See "The Bureau of Standards," Service Monograph of the U. S. Govt., No. 35, p. 173, prepared by the Institute for Govt. Research.

[10] Congressional Directory, 1937, p. 471.

[11] Annual Report of the Director of the Census, 1927, p. 4.

as the secretary of labor deems to be in the public interest to include.[12] In addition to many special publications containing statistical material and other information concerning labor, the bureau publishes a magazine called the *Monthly Labor Review*.

IV. Aid to the Mining Industry.

For many years the United States has cooperated with the mining industry in an effort to solve some of its complex problems. The agency primarily entrusted with this work is the Bureau of Mines, whose activities cover a wide range, varying from investigations which concern mining itself to studies of the consumption and use of mine products.

Among the important activities of the bureau is the promotion of the safety and health of miners. One of its outstanding achievements is the finding that coal dust, raised into the air by concussion, ignites and causes mine explosions. In order to decrease the dangers of mining, the bureau has investigated the kinds and uses of explosives and has succeeded in securing the extensive adoption of what are called "permissible explosives." The use of explosives of this type has greatly minimized the possibility of dust or gas explosions. Also, the bureau has secured the adoption in many places of improved types of hand lamps. Upon the finding that about half of the deaths in mine disasters result from falling roofs, the bureau has conducted investigations designed to eradicate the causes. The bureau has made a study of mine diseases also. Through safety stations and mine rescue cars the Bureau of Mines is performing an important service to mine workers. These cars go from place to place conducting demonstrations and in case of a disaster rush to the scene with aid.[13]

Technological investigations have occupied much time and effort of the Bureau of Mines. On behalf of the consumer it has investigated methods of effecting economies in the use of fuel, qualities of fuel products, and their uses for various purposes. On behalf of the producer it has studied ways of pre-

[12] U. S. Code, Title 29, Sec. 2.

[13] For statements of this work see, "The Bureau of Mines," Service Monograph of the U. S. Govt., No. 3, pp. 13–36, prepared by the Institute for Govt. Research. See also the article by Scott Turner, *U. S. Daily*, Nov. 5, 1928, p. 9.

venting waste in the treatment of ore and has conducted experiments to determine the efficiency of methods of mining, drilling, blasting, or loading ore.[14]

In its oil and gas investigations the bureau has endeavored to eradicate the tremendous losses which result from the waste of these natural resources. According to the bureau, this waste amounts to about $50,000,000 annually for natural gas alone.[15]

The Bureau of Mines has several experimental stations located at different points throughout the United States. These are used for conducting experiments of value to the mining industries of the various regions where they are located. The government maintains an experimental mine at Bruceton, Pennsylvania, which it operates entirely in the interests of scientific research.[16]

V. Aid to the Fishing Industry.

Among the important tasks of the Bureau of Fisheries of the Department of Commerce are its fish culture work, its studies of fish products for food and other uses, its investigations of fishing methods and equipment, and its protection of the Alaskan seals.

In its fish culture work the bureau has engaged in the artificial propagation and distribution of fish in the waters of the United States. From time to time new kinds of fish have been introduced from abroad.[17] In many cases the replenishment of fish has had considerable commercial importance. Although the United States has no constitutional authority to enact protective laws for fish within the states, it can refuse to maintain hatcheries, to stock the waters, or to protect fish in states which do not have adequate laws.

To improve fish products for food purposes, the Bureau of Fisheries has conducted extensive investigations in the refrigeration, canning, smoking, drying, and salting of fish. Research has been undertaken to discover uses for the by-products of fish. An interesting illustration of a service of this latter kind

[14] See the article in *U. S. Daily*, Nov. 6, 1928, p. 9.

[15] See the article by Scott Turner in *U. S. Daily*, Nov. 7, 1928, p. 9.

[16] For a description of the organization and work of the bureau, see that part of the Annual Report of the Secretary of the Interior, 1937, designated "Bureau of Mines."

[17] See "Federal Departmental Organization and Practice" by G. C. Thorpe, p. 419.

occurred during the World War. The United States was cut off from its supply of a certain product which was made from fish scales and which was essential for the manufacture of imitation pearls. With the aid of the bureau a new industry was developed in the United States which was able to supply this product.[18]

The Bureau of Fisheries is in charge of the seal herd which is located on the Pribilof Islands of Alaska. A limited number of animals of this herd may be killed each year and their furs sold. The importance of this work can be appreciated when it is realized that the seal on these islands constitute about 80 per cent of the world's supply. Without the protective efforts of the bureau the seal would have been completely exterminated and their furs would have disappeared as articles of commerce. Under the protection of the government the seal herd in Alaska grew from about 125,000 in 1911 to over 1,000,000 in 1930.[19]

The Bureau of Fisheries also has charge of the salmon fisheries of Alaska. It also administers the law for the protection of sponges on the coast of Florida.

VI. Financial Aid to Business.

The loans of the Reconstruction Finance Corporation afford one of the most spectacular and familiar illustrations of the aid which the Federal government extends to business. In the fall and winter of 1931 private funds became so difficult to obtain that Congress decided to create the Reconstruction Finance Corporation and give it the power to lend money directly to certain important businesses. The corporation has a capital stock of $500,000,000, which is subscribed to by the government of the United States. The management is vested in a board of directors consisting of the secretary of the treasury and six other persons appointed by the president with the advice and consent of the Senate.[20] The corporation is to have succession for a period of 10 years from the date of the enactment of the statute unless it is dissolved sooner by Congress. The powers of the Reconstruction Finance Corporation are those which are usually conferred upon a public corporation. It may sue and be sued,

[18] See the article by Lewis Radcliffe in *U. S. Daily*, Nov. 13, 1928, p. 10.
[19] Annual Report of the Commissioner of Fisheries, 1931, p. XXVIII.
[20] U. S. Code, Title 15, Sec. 603.

make contracts, lease real property, and appoint and fix the compensation of employees.[21]

The Reconstruction Finance Corporation is empowered to make loans to many kinds of businesses. It may lend money to banks, trust companies, credit unions, building and loan associations, insurance companies, and mortgage loan companies.[22] Under this part of the act the Reconstruction Finance Corporation had loaned over $2,500,000,000 to more than 9,000 organizations up to Mar. 31, 1938.[23] Upon approval of the Interstate Commerce Commission, loans may be made to railroads engaged in interstate commerce, to railroads in the process of construction, and to receivers of railroads when in the opinion of the board of directors such roads are unable to obtain funds upon reasonable terms through ordinary banking channels.[24] Also, the Reconstruction Finance Corporation may make loans to any industrial or commercial business if credit is not otherwise available at the banks. Loans of this type are supposed to be made for the purpose of maintaining or increasing the employment of labor.[25] All loans made by the corporation must be fully and adequately secured.

In addition to its power to lend money the Reconstruction Finance Corporation has been given the power to acquire stock in certain corporations. If a bank is in need of funds for capital purposes in connection with organization or reorganization, the secretary of the treasury with the approval of the president can request the Reconstruction Finance Corporation to subscribe for preferred stock or to make loans secured by such stock.[26] That this part of the law has been extensively used can be seen from the fact that the Reconstruction Finance Corporation had made loans on and subscriptions for preferred stock of banks and trust companies aggregating more than $1,200,000,000 up to Mar. 31, 1938.[27] The law also provides that if an insurance

[21] U. S. Code, Title 15, Sec. 604.

[22] U. S. Code, Title 15, Sec. 605.

[23] Quarterly Report of the Reconstruction Finance Corporation, Mar. 31, 1938, p. 2.

[24] U. S. Code, Title 15, Sec. 605.

[25] U. S. Code, Title 15, Sec. 606b.

[26] U. S. Code, Title 12, Sec. 51d.

[27] Quarterly Report of the Reconstruction Finance Corporation, Mar. 31, 1938, p. 2.

company is in need of funds for capital purposes, the secretary of the treasury with the approval of the president can request the Reconstruction Finance Corporation to subscribe to preferred stock or to loan money secured by such stock.[28]

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[28] U. S. Code, Title 15, Sec. 605e.

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CHAPTER XXIV

FEDERAL GOVERNMENT OWNERSHIP AND OPERATION

I. The Postal System.

The clause of the United States Constitution which provides that Congress shall have the power to establish post offices and post roads has given to the Federal government the authority to undertake its largest business venture, the postal system. The postal power is one of the most extensive which the Federal government enjoys. Under its provisions the Federal government may act in a proprietary as well as in a regulatory capacity.

The Post Office had its beginning in 1789, when an act of Congress provided for the appointment of a postmaster general.[1] However, the Post Office did not become an executive department until 1872.[2] During the early part of its existence the Post Office performed few of the functions which are now regarded as an almost indispensable part of its services. The registration of mail was not inaugurated until 1855, urban free delivery was first offered in 1863, the money order system was commenced in 1864, rural free delivery was begun in 1896, the postal savings system was instituted in 1911, the parcel post was commenced in 1913, and air mail service was started in 1918.

1. *Organization.* The postmaster general is executive head of the Post Office and has general direction and supervision of its services. He appoints all officers and employees of his department except certain higher officials, such as the four assistant postmasters general, the solicitor, the purchasing agent, and the comptroller.[3] Subject to presidential approval he makes postal conventions and agreements with foreign governments.

[1] Stat. L. 70.

[2] 17 Stat. L. 283. For a brief statement of the history of the Post Office see "Federal Departmental Organization and Practice" by George C. Thorpe, Chap. 23.

[3] U. S. Code, Title 5, Secs, 363–366; U. S. Code, Title 31, Sec. 45; U. S. Code, Title 39, Sec. 31.

He awards and executes contracts for air mail and ocean mail service. He promulgates the many rules and regulations of the Post Office Department.

Each of the four assistant postmasters general is in charge of a group of somewhat related functions. The first assistant postmaster general has under his control the division of postmasters, the division of dead letters, and the post-office service division. The second assistant postmaster general has under his supervision the divisions which are in charge of railway adjustments, international postal service, the railway mail service, and air mail. The third assistant postmaster general is in charge of those divisions which handle money orders, stamps, classification of mail, registered mail, and postal savings. The fourth assistant postmaster general has under his control the divisions of motor-vehicle service, post-office quarters, equipment and supplies, and engineering and research.[4]

There are a certain number of officers of the department, such as a comptroller, a solicitor, a purchasing agent, and a chief inspector, who are not under any of the four assistant postmasters general.

2. *Personnel Policies.* The postal service, with more than 300,000 employees, presents certain difficult problems of personnel administration. The necessity of preventing nepotism and politics and yet keeping an organization from being strangled by its own red tape is obvious. Some of the greatest objections to government ownership and operation arise from a failure on the part of the government to solve satisfactorily its personnel problems. In its program of legislation for the Post Office, Congress has endeavored to offer a solution for some of these difficulties by placing almost the entire personnel of the postal system under civil service rules and regulations.

Most appointments to the postal service are made under the supervision of the postmaster general in accordance with civil service regulations. In order to qualify for most postal appointments, candidates are required to take examinations. The names of all persons who pass such examinations with an average grade of 70 are placed upon a register. When an employee is needed, the Civil Service Commission supplies the appointing officer with the names of the three candidates having the highest grades.

[4] See the Annual Report of the Postmaster General, 1937, pp. 10–68.

Appointment is made from one of these.[5] A person appointed under civil service regulations is placed on probation for a period of six months, and his appointment becomes final only if he is retained beyond that time.[6]

No system of civil service is adequate without provisions which guard against removals for personal or political reasons. At the same time, a system which does not allow some method of removal encourages inefficiency. Realizing this, Congress has provided that no person in the classified civil service is to be removed except for a cause which will promote the efficiency of the service. When the removal of an employee is sought, he must be notified of the charges against him and must be given a reasonable period of time in which to answer.[7]

It is likewise essential in a complete system of civil service to provide for promotions. Again, a proper middle course must be devised which avoids the dangers of political and personal favoritism on the one hand and official and bureaucratic stagnation on the other. In the lower positions the postal service has a regular system of promotions. After one year of satisfactory service, letter carriers and clerks in the first- and second-class post offices are to be promoted successively to the next higher rank until they reach the fifth grade. No promotion is to be made except upon satisfactory evidence of the faithfulness and efficiency of the employee during the preceding year.[8] As a basis for recommendation a system of merits and demerits is used on which to grade employees. Every three months, recommendations are submitted for all persons who are eligible for promotion and who have made an efficiency rating of 60 per cent or more.[9]

Arrangement for retirement after a certain number of years of service is a feature of personnel administration in which employees are vitally interested. All employees in the classified civil service of the United States who have reached the age of seventy and who have rendered 15 years of service are eligible for retirement on an annuity. Certain classes of persons, such as

[5] See Rule VII *a* and *b* of the Civil Service Commission.

[6] See Postal Laws and Regulations of 1932, Sec. 454.

[7] U. S. Code, Title 5, Sec. 652.

[8] U. S. Code, Title 39, Secs. 108 and 109.

[9] See U. S. Official Postal Guide, 1931, p. 67.

city and rural mail carriers and post-office clerks, are eligible to retire at sixty-five. Railway mail clerks may retire at sixty-two.[10]

Two more provisions of special interest to employees should be mentioned. Postal workers are allowed sick leaves and leaves of absence.[11] Furthermore, the United States is required to pay compensation to an employee for disability or death which is sustained during the performance of his duty, provided such injury has not been due to the employee's own willful misconduct. Claims are addressed to the United States Employees' Compensation Commission, whose duty it is to determine the amount of compensation which is to be paid in each case.[12]

3. *Post Offices and Post Roads.* The Constitution of the United States gives to Congress the power to establish post offices and post roads. Congress has declared by statute that the following are post roads or post routes: railroads, waters and canals, public roads and highways, and letter-carrier routes which have been established in any city or town for the collection and delivery of mail matter.[13]

The postmaster general has been given the authority to establish post offices at such places as he may deem expedient and to establish one or more branch offices in connection therewith.[14] More than 44,000 post offices were in existence in 1937.[15] These are divided into first, second, third, and fourth classes. The class to which a post office belongs depends upon the fiscal receipts during the preceding year.[16] A large number of stations and branches have also been established. These are divided into two classes, "classified" and "contract." The "classified" stations are operated by regular postal employees, are located in quarters provided by the government, and furnish practically the same services as post offices. "Contract" stations are located in drug stores, department stores, or other places of business and are conducted under special agreements. Persons who

[10] U. S. Code, Title 5, Sec. 691.

[11] U. S. Code, Title 39, Sec. 823.

[12] U. S. Code, Title 5, Sec. 751. See the note to Sec. 40, Postal Laws and Regulations, 1932; see also U. S. Official Postal Guide, 1936, p. 85.

[13] U. S. Code, Title 39, Secs. 481 and 482.

[14] U. S. Code, Title 39, Secs. 1 and 158.

[15] Annual Report of the Postmaster General, 1937, p. 116.

[16] U. S. Code, Title 39, Secs. 53 and 54.

operate "contract" offices are required to furnish equipment, heat, light, and clerical assistance.[17]

The postmaster general may discontinue any post office when the safety, security, or revenue of the postal service is endangered or when the efficiency of the service requires the discontinuance.[18]

4. *Mail Matter.* The mail which the Post Office handles is divided into first-, second-, third-, and fourth-class matter. The law has set different rates, has prescribed different methods of fixing rates, and has provided for different treatment for each class of mail. First-class mail embraces all written matter, all matter which has been sealed or closed against inspection, postal cards, and private mailing cards. The rate on most so-called first-class material is three cents an ounce, but for postal cards and private mailing cards it is one cent each.[19]

Second-class mail embraces all newspapers and other periodical publications which are issued at regular periods of time. Rates for second-class mail are very reasonable and are the lowest for any of the four classes of mail. They are fixed at so much per pound and vary according to distance. Before a publication will be granted second-class privileges, an application must be made to the postal authorities. When a paper or magazine is offered for dispatch through the mails for the first time, the postmaster requires the publisher to file an affidavit and two representative copies of the publication. A permit accepting the publication conditionally for transmission as second-class matter is issued, and a deposit is required which is enough to cover the third- or fourth-class rates. The question of whether or not such publication can be admitted to the privileges of second-class mail is referred to the third assistant postmaster general. To be entitled to admission to this class of mail, the publication must be issued at stated intervals and at least four times every year, must bear a date of issue and be numbered consecutively, must be issued from a known office of publication, must be formed from printed paper sheets without cloth or leather binding, and must be devoted to literature, science, industry, or to the spreading of information. Publications designed for advertising purposes or publications which are distributed free or at nominal

[17] See Rules and Regulations of the Post Office, 1932, Sec. 403.

[18] U. S. Code, Title 39, Sec. 2.

[19] U. S. Code, Title 39, Secs. 221–223 and 280–281.

rates are not admitted as second-class matter. Under some circumstances, however, free publications of benevolent societies or institutions of learning are granted the privileges of second-class mail.[20]

Third-class mail comprises all circulars and other matter which is printed (including books and catalogues having 24 pages or more) merchandise, seeds, bulbs, and all other mailable matter which is not embraced in the first and second classes. Third-class mail, however, includes only packages which weigh eight ounces or less.[21]

Fourth-class mail, commonly known as parcel post, embraces all matter exceeding eight ounces which is not included in the first or second classes. For purposes of determining the rates, a system of eight zones has been fixed. These zones are based upon the radial distance from the places of dispatch. For example, the first zone includes all post offices within a radius of 50 miles, the second within a radius of 150 miles, and the third within a radius of 300 miles. Rates vary according to distance and weight.[22] The maximum size of packages which may be sent is 100 inches in girth and length combined, and the maximum weight is 70 pounds.[23]

Unlike rates for other classes of mail, the rates for fourth-class matter may be changed without action by Congress. If the postmaster general finds from experience that the classfication of articles, the weight limit, the rates of postage, or other conditions are such as to prevent the shipment of desirable articles or to make the cost of service greater than the receipts, he may change them after he has secured the consent of the Interstate Commerce Commission.[24] Although there has been some criticism of this provision, there seems little doubt but that it is in the interests of efficiency. The postmaster general is in a better position than Congress to know the needs of the department. Furthermore, he can act with much more speed. There is

[20] U. S. Code, Title 39, Secs. 224–229 and 283–288; Postal Laws and Regulations, 1932, Secs. 529–531.

[21] U. S. Code, Title 39, Secs. 235–239, and 291; U. S. Official Postal Guide, 1936, p. 12.

[22] U. S. Code, Title 39, Secs. 240 and 292–293; see also U. S. Official Postal Guide, 1936, p. 13.

[23] Postal Laws and Regulations, 1932, Sec. 577.

[24] U. S. Code, Title 39, Sec. 247.

little danger that such power will be abused because of the requirement that the Interstate Commerce Commission must consent to any changes.

In 1933, the president was given authority to modify postage rates. This authority expires in June, 1939. Acting under this power the president reduced the postage rates on books to 1½ cents per pound irrespective of the zone of destination.[25]

In general, the things which fall into the class of unmailable matter are of two kinds, those which hinder the efficiency of the service, and those which are contrary to the safety, health, or morals of the public. The first group includes materials which are unmailable because they are illegible, because they exceed a certain size or weight, or because they are liable to damage the contents of mail bags. The second group consists of obscene matter, treasonable literature, libelous or indecent material, fraudulent matter, and lottery devices.[26] In forbidding the shipment of matter in this latter group, Congress has evidently made use of its implied powers. Although Congress is given the authority to establish post offices and post roads, it is not given any express power to protect the morals or health of the people of the United States. Nevertheless, the courts have upheld the validity of legislation which prohibits the transportation of the above-mentioned commodities. In upholding this legislation the courts have declared that Congress is not obliged to furnish mail facilities to all persons and for all purposes, and that Congress therefore must have some discretion to determine what should be excluded from the mails.[27]

A vast amount of mail matter is carried by the postal system without charge. The vice-president, senators, and representatives send and receive franked mail. Likewise, various bureaus and divisions of the Federal government may send without charge material which relates to the business of the United States. Reading matter for the blind and certain reports and bulletins of agricultural colleges and experiment stations may be sent free of charge through the mails.[28] The postal laws allow publica-

[25] 48 Stat. L. 254 and 50 Stat. L. 358; *Federal Register* Nov. 1, 1938, p. 2588.

[26] See Postal Laws and Regulations, 1932, Sec. 597; U. S. Code, Title 18, Secs, 334–338.

[27] *In re* Rapier (1892) 143 U. S. 110, 36 L. Ed. 93, 12 S. Ct. 374.

[28] U. S. Code, Title 39, Secs. 321–335.

tions of the second class, one copy to a customer, to be sent without charge within the limits of the county where printed and published. This latter privilege extends only to publications which are mailed at and to post offices which do not have letter-carrier service. If a publication is entitled to this service, it is entitled also to delivery by rural route carriers.[29]

One or two remarks should be made also about the treatment of mail matter. Because the constitutional provision in the Fourth Amendment guarantees persons, papers, houses, and effects against unreasonable searches and seizures, mail which has been sealed against inspection may not be opened even though it is suspected of containing material which is unmailable. Sealed mail, however, may be opened by an employee of the dead-letter office or some official with a search warrant.[30] Withdrawal of mail is not allowed except by the sender, who may recall it even after its dispatch.[31]

5. *Delivery Service.* Four methods are provided by the postal service for delivery of mail—general delivery, distribution in post-office boxes, city and village delivery, and rural delivery. The last two types require brief comment.

Urban free delivery of mail has so long been a part of the service rendered by the postal system that it is difficult to realize that during the period before 1863 such accommodation was not furnished. The postal laws contain a mandatory provision for the establishment of this service in every incorporated city, village, or borough with a population of 50,000 or more. It may be established in other places at the discretion of the postal authorities. If a place has a population of 10,000 or more or if a post office has a gross revenue of not less than $10,000, application may be made to the first assistant postmaster general for the establishment of city delivery service. The limits of such service and the frequency of trips are fixed by the department.[32]

Under such rules and regulations as the postmaster general prescribes, village delivery may be established in towns and vil-

[29] U. S. Code, Title 39, Sec. 286; Postal Rules and Regulations, 1932, Sec. 543.

[30] U. S. Code, Title 18, Sec. 343; *In re* Jackson (1878) 96 U. S. 727, 24 L. Ed. 877.

[31] Postal Laws and Regulations, 1932, Sec. 729.

[32] U. S. Code, Title 39, Sec. 151; Postal Laws and Regulations, 1932, Sec. 903.

lages having second- and third-class post offices or in communities adjacent to localities having city delivery service. In order to qualify for this service, villages and towns must have certain civic improvements such as sidewalks, street lights, and house numbers; must have a population of at least 1,500; and must have produced postal receipts amounting to at least $5,000 for the preceding year.[33]

Rural free delivery, a service which has meant much to the agricultural population of the United States, is of comparatively recent date, having been established in 1896. The law provides that rural free delivery shall be established so as to serve as nearly as practicable the entire rural population of the United States. All persons are entitled to the benefits of such service provided they will erect approved boxes on any mail route in a manner prescribed by the Post Office Department. Carriers on rural routes are required to furnish and maintain at their own expense all necessary vehicle equipment for the proper handling of rural mail.[34]

6. *The Transportation of Mail.* The transportation of mail is performed largely on facilities which are not owned or operated by the government. The most important of these are railroads, electric railways, messenger service, "star" service, airplanes, and steamships.

For the conveyance of mail over railroads, several types of facilities are in use. The first of the these is *railway post office car* which must be at least 40 feet in length and must be equipped with apparatus for handling and distributing mail in the course of transit. The second type, *apartment car space,* consists of a compartment 15 or 30 feet in length in a car which has been provided with equipment for the distribution of mail. The third type, *storage car,* is used for the conveyance of large quantities of mail in bulk and is not equipped for the distribution of mail. The fourth, known as *storage car space,* is similar to the storage car except that only a part of a car is used for the transportation of mail. The fifth, which is called *closed pouch* service, consists of a unit of car-space varying from 3 to 15 feet. In *closed*

[33] U. S. Official Postal Guide, 1936, p. 29; Postal Laws and Regulations, 1932, Sec. 949.

[34] U. S. Code, Title 39, Secs. 191 and 194; U. S. Official Postal Guide, 1936, p. 35.

pouch service the handling of the mail is entirely in the hands of railroad employees.[35]

The law requires that the rates of pay for transportation of mail by the railroads must be just and reasonable. The Interstate Commerce Commission has been given the power to determine and to fix the fair and reasonable rates for the carriage of mail by railways.[36] At the present time such compensation is fixed upon a space-mile basis. In other words, the compensation which is paid to the carrier depends upon the amount of car-space utilized, the kind of car furnished, and the distance which the mail is carried.[37]

The Interstate Commerce Commission has been given authority to fix fair and reasonable rates for the carriage of mail by urban and interurban electric railways.[38] It has done this upon a somewhat different basis from that used for steam railroad transportation.[39]

The postmaster general is authorized to make provisions for "mail messenger" service. Such service is supplementary to other methods of transportation, being used chiefly to carry mails between stations, docks, or post offices. Persons who furnish this service are selected by the postal authorities, after the submission of public bids.[40]

Another method of transportation of mail is by the so-called "star" service, which is used where railroads or interurban railways are not available or where their connections are circuitous or their schedules are untimely. Transportation by "star" service is performed in many ways, depending upon the climate and nature of the terrain; sometimes it is carried by automobile, sometimes by horse, and sometimes even by sailboat.[41] The Annual Report of the Post Office for 1937 shows that at that time there were more than 11,000 "star" routes in existence.[42] A

[35] U. S. Code, Title 39, Secs. 525–530; Railway Mail Pay (1919) 56 I. C. C. 1.

[36] U. S. Code, Title 39, Secs. 542–552.

[37] Railway Mail Pay (1928) 144 I. C. C. 675 (717–718).

[38] U. S. Code, Title 39, Sec. 570.

[39] Electric Railway Mail Pay (1925) 98 I. C. C. 737.

[40] Postal Laws and Regulations, 1932, Secs. 1768–1771.

[41] For a description of some of these routes and the difficulties encountered by operators see *Bulletin* No. 6 of the Post Office Information Service.

[42] Annual Report of the Postmaster General, 1937, p. 14.

few "star" routes are operated by the government, but by far the greater number are operated by private individuals under contract. Such contracts are entered into after a public advertisement of the various routes over which service is to be offered and the receipt and acceptance of bids by the second assistant postmaster general. Awards are made for a period of four years. The service performed by the operators of "star" routes varies considerably; it sometimes includes only the transportation of first- and second-class mail, but sometimes it includes not only the transportation of mail between post offices but also box delivery and collection service on the route.[43]

Another method of transportation of mail which has been of increasing importance is carriage by airplane. The first authority for the establishment of air mail service was contained in the Postal Service Appropriation Act of 1917.[44] By subsequent legislation air mail has become firmly established as a recognized means of transportation. For a time the Federal government owned and operated a fleet of planes for transcontinental air mail service, but as soon as the practicability of air transportation had been demonstrated, the Federal government discontinued the use of its own planes and entered into contracts with private parties for transportation of the mail. The postmaster general has power to award contracts to the lowest bidder for the transportation of mail by aircraft between such points as he determines.[45]

The postal laws provide for the transportation of mail between the United States and foreign countries. The postmaster general has the authority to enter into contracts with steamship companies after advertising for bids.[46] Although such contracts may be made with foreign as well as with American vessels, Congress tried to encourage the growth of American shipping by requiring that all mail of the United States which is shipped or carried on vessels shall, if practicable, be carried upon American-built vessels documented under the laws of the United States. Fur-

[43] For the form of these bids and list of some of the routes see the *Bulletin*, "Advertisement Inviting Proposals for Carrying the Mails of the United States on Star Routes in the State of Indiana," 1930.

[44] 39 Stat. L. 1064.

[45] U. S. Code, Title 39, Sec. 469.

[46] U. S. Code, Title 39, Secs. 651–654.

thermore, Congress has classified ships into seven groups based upon tonnage, ranging from 2,500 to 20,000 tons, and upon speed, ranging from 10 to 24 knots. The rates of compensation for mail carried by such ships vary in proportion to the tonnage and speed. The postmaster general is authorized to enter into contracts for the carrying of mail by such vessels after giving public notice and receiving bids.[47]

7. *The Registration, Insurance, C. O. D., and Money-order Services.* The Post Office has undertaken certain services which are auxiliary to its primary function, the transportation of mail. The first of these, the registry system, has been in existence since 1855. Upon request, all first-, second-, and third-class matter may be registered; fourth-class may be registered if it is sealed and the first-class rate is paid. Mail carriers are held responsible for the loss or depreciation of a registered letter or parcel which has been placed in their custody. If, however, there is reason to believe that the registered mail contains a large sum of money or valuable securities which would subject the carrier to unusual risks, the postal authorities require the party to whom it is addressed to call for the package or the letter. The statute provides that the maximum indemnity shall not exceed $1,000 for any piece of registered mail. In the case of irreparable damage the indemnity is the value of the object at the time of the loss, and in the case of partial damage the indemnity is the cost of duplicating the same.[48]

Another important service similar to that of registration is insurance for articles sent by third- or fourth-class mail. The maximum indemnification which may be paid for a parcel is $200.[49]

A feature of the postal system which has been proved to be of tremendous value to mail-order houses and other companies using the mails is the C. O. D. service, which permits persons to send goods to a buyer and have the price collected by the postal employees at the time the parcel is delivered. This service may

[47] U. S. Code, Title 46, Secs. 880 and 891e-891m. For a list of contracts entered into under this act see the Annual Report of the Postmaster General, 1930, p. 141. For a notice of the specifications and an advertisement for bids under the act see *U. S. Daily*, Jan. 20, 21, and 22, 1930.

[48] U. S. Code, Title 39, Secs. 381–386; Postal Laws and Regulations, 1932, Sec. 1203.

[49] U. S. Code, Title 39, Secs. 244–245.

be used only for bona fide orders or agreements between the sender and the receiver. The examination of parcels which are sent C. O. D. is not permitted until charges have been paid.[60]

According to the statute, the purpose of undertaking a money-order system is to promote the public convenience and to insure greater security in the transfer of money through the mail. In order to carry out this statutory purpose, the postmaster general has been given the power to establish and maintain a uniform money-order system.[61] No money order may be issued for more than $100. A small fee, depending upon the size of the order, is charged for the service.[62] Certain restrictions have been made concerning the endorsement, the time of payment, and the repayment of money orders.[63]

8. *The Postal Savings System.* The postal savings system has little to do with the primary function of the Post Office but is primarily a government banking enterprise. The advantages of entrusting its operation to the Post Office Department are obvious. In the first place, the far-flung postal facilities afford to a large portion of the public ready access to these banking privileges. In the second place, the government is able to offer this service with a minimum of added cost by making use of the postal facilities.

It has often been stated that the purpose of establishing a postal savings system is not to compete with existing banking facilities but to draw out money which has found its way into strong boxes, bureau drawers, or other places of hiding.[64] In other words, it is alleged to be designed to appeal to persons who for various reasons do not wish to make use of ordinary banks. Restrictions which are placed upon persons who may open accounts and restrictions which are placed upon the total amount that may be deposited in the name of one customer seem to support this contention.

[60] U. S. Code, Title 39, Secs. 244–246d.

[61] U. S. Code, Title 39, Sec. 711.

[62] U. S. Code, Title 39, Sec. 716.

[63] U. S. Code, Title 39, Secs. 718, 723, and 728; Postal Laws and Regulations, 1932, Secs. 1427–1430, 1442, and 1443.

[64] See, for example, the statement in Annual Report of the Postmaster General for 1931, p. 37; see also the discussion in "Postal Savings" by Edwin Kemmerer, pp. 15–16.

The postmaster general does not have as complete control over the postal savings system as he has over the other services of his department. He designates post offices as depositories and makes certain routine regulations concerning hours, the issuance of pass books, and deposits and withdrawals of money.[55] A board of trustees, consisting of the postmaster general, the secretary of the treasury, and the attorney general, exercises control over the more important features of the system.[56]

Any natural person who is 10 years of age or more may open an account in his own name. However, the privileges of the postal savings system are not open to societies, corporations, partnerships, or associations. The law sets a minimum of $1 and a maximum of $2,500 for each account. Although deposits must be made in amounts of $1 or multiples thereof, postal savings stamps are issued for small amounts. Interest at the rate of 2 per cent per annum is paid upon deposits. As evidence that a deposit has been made, postal savings depositors are given nontransferable certificates issued in denominations varying from $1 to $500. Any depositor may withdraw the whole or any part of his funds with accrued interest upon demand and upon the surrender of his certificate.[57]

Postal savings bonds are another form of saving offered by the Post Office. Any depositor may surrender his deposit or any part thereof and receive bonds of designated denominations which bear interest at the rate of 2½ per cent per annum. These bonds are payable in 20 years but may be redeemed at the pleasure of the United States after 1 year from the date of issue. Although bonds are issued only upon the surrender of postal savings deposits and to persons who are depositors, they may be sold or assigned by the owner to any other person. The board of trustees will purchase the bonds at par value plus accumulated interest upon the application of any holder. Although there is no limit to the amount of postal savings bonds which may be acquired by one depositor, such bonds are not always obtainable. They are issued only when there are outstanding bonds of the United States subject to call or when the Federal government

[55] U. S. Code, Title 39, Sec. 768.
[56] U. S. Code, Title 39, Sec. 751.
[57] U. S. Code, Title 39, Secs. 754–758.

desires to issue bonds for the purpose of replenishing its treasury.[58]

Postmasters are required to keep funds deposited by patrons of the postal savings system in an account which is separate from other postal moneys. The law requires that such funds shall be deposited in state or national banks which have the proper qualifications. The trustees of the postal savings system must obtain from depository banks sufficient security to insure the prompt payment and the safety of these funds. The law provides that postal savings deposits are to be divided among the qualified banks of a community in proportion to the capital and surplus of each.[59]

During the past few years the increase in postal savings has been tremendous. Persons have desired a safe place in which to deposit their money and at the same time receive a small rate of interest. Undoubtedly the system has competed to a certain extent with banks, but it has also probably kept large sums of money in circulation which otherwise would have gone into hiding. The competition with banks is mitigated by the provision that money deposited locally is in turn redeposited with qualified local banks.

9. *The Universal Postal Union.* One of the outstanding features of the postal service is the ease with which and the small cost at which international mail may be transported. When one realizes, for example, that a letter may be sent for 5 cents to almost any corner of the globe, whereas it formerly cost as much as $2.50, one begins to comprehend the magnitude of this achievement.[60] The remarkable cooperation which has bound almost the entire world into a single unit is due to one of the oldest and best known of international organizations, the Universal Postal Union. Every civilized state and many which cannot be so designated are members of this organization. The states outside the union constitute a small and insignificant group.[61]

[58] U. S. Code, Title 39, Sec. 760.

[59] U. S. Code, Title 39, Secs. 759–760.

[60] See the special pamphlet put out by the Post Office entitled, "Universal Postal Union."

[61] For a list of the members of the Union see "International Communications" by Keith Clark, p. 33.

The Universal Postal Union had its beginnings in the Berne Convention of 1874. Although subsequent conventions have made many changes, the provisions of the Berne Convention still form the basis upon which the union operates. Among the fundamental principles laid down by the various conventions are uniformity of rates, uniformity of weights, simplification of accounts, and uniform classification of mail. The conventions have established a maximum postal rate of 25 centimes (about 5 cents) for letters. They have fixed also certain weight limits for mail.

The permanent executive organ of the Universal Postal Union is the bureau which is located at Berne, Switzerland. One of its important duties is the compilation and distribution of information on international postal service. Another of its duties is to act as a clearinghouse in the settlement of accounts among the members of the Postal Union.[62]

10. *Postal Revenues.* The subject most often discussed in popular articles on the Post Office and one which seems to be of perennial and recurring interest is the postal deficit. During a large part of its history the Post Office has operated at a loss. For a brief span beginning in 1917, while increased rates were in effect, the Post Office showed a profit. When rates were lowered in 1919 the deficit reappeared. For the year ending June, 1932 the deficit reached the unprecedented total of $205,000,000.[63] In 1937 it had fallen to approximately $46,000,000.[64]

Critics of the Post Office and of government ownership in general point with glee to the constantly recurring deficits which are incurred by this great Federal business venture. That there are wastes and inefficiencies cannot be denied, but most of the wholesale charges and attacks are unjustified. In the first place, the government is not in the postal business to make a profit but to afford a service to the people. The postal service cannot be judged by the same standards or measured by the same yardstick as that applied to private business enterprises. It is supposed to reach and does reach the most remote sections of the United States and outlying possessions. That many of the routes and stations are unremunerative is obvious. If they were

[62] "International Communications" by Keith Clark, pp. 40–41.

[63] See the Annual Report of the Postmaster General, 1932, p. VII.

[64] See the Annual Report of the Postmaster General, 1937, p. XI.

parts of a strictly private business or even a public utility, the operators would withdraw the facilities. In the second place, a large part of the postal deficit is the result of deliberate subsidies on the part of the Unlted States which may or may not be justified but which swell the total deficit greatly. It has been estimated that of the $205,000,000 deficit for the fiscal year ending June, 1932 about $53,000,000 was the result of nonpostal expenditures due to subventions of the national government or to free transportation of mail. Numerous publications of labor, agricultural, fraternal, scientific, religious, or educational societies, such as the *Christian Science Monitor*, the *American Political Science Review*, and the *National Geographic Magazine* are given very low pound rates. The free transportation privileges granted to newspapers within a county, the franking privilege of Congressmen, and the franking privilege enjoyed by the various departments of the Federal government increase greatly the postal deficit. If to these items one adds rates which amount to subventions for the air service and the merchant marine, one can realize in part why the postal deficit is so large. In the third place, it should be remembered that the Post Office has been and probably could be operated at a profit. This seems to have been amply demonstrated by the experience of the government from 1917 to 1919. In normal times an increase in the rates of first-class mail would probably go a long way toward eradication of the deficit.

In justice to those who regard the postal deficit as evidence of the inefficiency of government operation it should be pointed out that the postal service does not pay taxes and does not pay for the erection of post-office buildings. If allowances were made for such items, the annual deficit would be materially increased.

It is interesting to note that, even though first-class mail more than pays its way, suggestions for decreasing the postal deficit usually embody an increase in the rates for this class of mail. The reason for confining increases to this class seems to be a fear that increases in other classes will drive business into the hands of private corporations, such as the American Railway Express Company.

11. *Advantages and Disadvantages of Government Ownership of the Post Office.* The Post Office is the largest business enterprise, not only of the Federal government, but also of the state and

local governments. Inasmuch as it has been used by both exponents and opponents of government ownership to prove their contentions, an effort will be made to present briefly some of its commendable and some of its objectionable features.

On the debit side there is the constantly recurring deficit, which has been discussed in a previous section. Another feature of the system which is not above criticism is the erection of post-office buildings. Such plants are often far more elaborate and costly than is necessary for the adequate performance of postal functions. Moreover, whether or not a particular locality obtains a post office does not always depend upon the needs of the community but often upon the prestige of a congressman. Furthermore, patrons find certain formality and red tape which might not exist in a private enterprise. Finally, the red tape and formality in the application of personnel policies is a handicap to the service.

On the other hand, the services of the Post Office extend to every corner of the United States and are performed at remarkably low rates. More than this, the Federal government has a very good policy toward its employees. Retirement provisions, compensation for injuries, sick leaves, and a very adequate scale of pay for persons in the lower ranks are among the commendable features. Furthermore, the numerous costly and vexatious legal questions which are constantly arising under government regulation of other utilities are quite foreign to the postal service. Questions of discrimination, valuation, rate of return, discontinuance of service, and going value, which are so costly and which give rise to so many difficulties for courts, commissions, and consumers, play no part in the operation of the postal system. Finally, it should be noted that although there are some delays and some inefficiencies, the Post Office performs its gigantic task with rapidity, accuracy, and very few losses considering the vast quantity of mail which its employees are required to handle daily.

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CHAPTER XXV

FEDERAL GOVERNMENT OWNERSHIP AND OPERATION (Continued)

II. Government Corporations.

Until a comparatively recent date, ownership and operation of business enterprises by the Federal government was undertaken through regular administrative bureaus or divisions. The Post Office is a typical illustration. Headed by a cabinet officer, it is divided and subdivided and operated much as are other departments and bureaus of the Federal government which perform noneconomic functions. Likewise, as a rule, when state and municipal governments have undertaken business enterprises they have merely organized bureaus or divisions to operate the businesses. In recent years there has been a tendency, especially on the part of the Federal government, to follow a new pattern in undertaking business enterprises. Instead of merely establishing new bureaus or divisions, Congress has tended more and more to create government corporations modelled to some extent on corporations which operate private businesses.

One of the first government corporations which was established by Congress was the Panama Railroad Corporation, created in 1904. During the World War the movement to establish government corporations gained considerable momentum. Many of the well-known emergency agencies established by Congress were government corporations. The Emergency Fleet Corporation, the United States Grain Corporation, the War Finance Corporation, the United States Housing Corporation, the United States Equalization Board are among the better known of the government corporations which were established during the World War.

Between 1920 and 1930 only a few government corporations, of which the Inland Waterways Corporation and the Federal Intermediate Credit Banks are the outstanding illustrations, were created by Congress. Beginning in 1932 the number of

government corporations increased rapidly. On Oct. 1, 1936 there were in existence more than 90 corporations in which the Federal government owned all or a majority of the stock.[1] In general, these corporations have been organized to conduct enterprises which are not considered to be traditionally governmental in character. Operation of railroads and barges, production of electricity, operation of banking and credit enterprises, dealing in surplus commodities, and the performance of similar services for which these companies were created are commonly considered to be nongovernmental functions. However, the mere performance of services never before undertaken by the government would not of itself be a reason for employing a new type of administrative organization unless such organization had certain advantages over the ordinary bureau.

The corporate form of organization has advantages which make it more efficient and more adaptable to the operation of business enterprises than the ordinary administrative bureau and division.[2] Corporations are legal and economic entities. Because they are independent units legislatures usually free government corporations from many of the restrictions ordinarily imposed upon other administrative units of government.

One of the most important advantages which a government corporation generally enjoys is a measure of financial autonomy. For the ordinary bureau, Congress appropriates money and often itemizes in detail the purposes for which expenditures may be made. Revenues must be turned into the Treasury of the United States. Furthermore, bureaus are not permitted to borrow money. They must conform to certain accounting regulations which are designed to prevent political abuses. Such restrictions are obviously a considerable handicap to persons who are attempting to operate a financial or business enterprise. On the other hand, government corporations usually enjoy considerable financial freedom. Many of them are financed originally through the issuance of capital stock. In the use of this capital, the directors of the corporation are permitted much discretion. In addition, such corporations may borrow money.

[1] See "Government Corporations in the United States" by Herman Pritchett, 19 *Southwestern Social Science Quarterly* 188, September, 1938.

[2] See "Government Corporations in the United States" by Herman Pritchett, 19 *Southwestern Social Science Quarterly* 188, September, 1938.

Usually the corporation may use the income derived from the operation of the business to pay expenses.

Another advantage which is usually given to government corporations is immunity from those statutes and regulations which are binding upon ordinary governmental agencies concerning the purchase of supplies, the awarding of contracts, and similar matters. Although such restrictions upon government bureaus and divisions have been adopted to prevent certain obvious abuses, they have imposed a formalism which stands in the way of efficient operation.

In addition, government corporations have usually been less restricted in their personnel policies than ordinary governmental agencies. Such corporations have a position similar to that of private corporations in hiring, promoting, and otherwise dealing with their employees. Because of their somewhat independent status and their freedom in matters of finance, they should be more immune than other governmental agencies from political pressure. In turn, this should make it less imperative to place them under the Civil Service. Although the Civil Service achieves certain desirable ends in protecting government bureaus from political appointments, it imposes restrictions and introduces a certain formalism which impedes the application of many desirable personnel policies.

Another advantage of government corporations is the opportunity that they offer for regional decentralization, which is highly desirable if the task to be performed is confined to a certain locality. In an administrative agency the lines of authority must run finally to the seat of government. If a corporation is organized and its task is local in character, its principal offices may be at the site of operations. This has an advantage in that decisions can be reached speedily and programs can be planned and worked out with a more intimate knowledge of local problems.

Finally, the formation of corporations affords a convenient device for limiting the sovereign immunity of the Federal government. A corporation performs functions similar to those performed by private corporations. Its liabilities and obligations should be similar to those of corporations with which it daily comes in contact. Congress can give to each corporation as much or as little immunity as seems desirable under the circumstances.

Federal corporations may be incorporated under state law or under Federal law. However, there seems little reason for creating such corporations under state law. There is no advantage to be gained by placing them under the jurisdiction of another sovereign. In providing for Federal incorporation, Congress may adopt one of two types of procedure, either enact a general incorporation act under which all government corporations are organized or enact a special statute for each corporation. This latter procedure is the one which has been generally followed, although there have been advocates of the former method.[3]

Obviously the powers of government corporations must vary with the type of task which is to be performed. However, most of them have been given and should be given certain powers which are common to all such corporations. They should have the power to sue and be sued, to enter into contracts, to buy, own, and dispose of such property as is necessary for the conduct of their business operations, to appoint and control their employees without restriction, to control their finances, and to make rules and regulations governing the conduct of their businesses. A government corporation is likely to function best if it has a board of directors which acts as a policy-determining agent but which does not interfere with administration. The details of administration should be entrusted to a general manager.

It is obviously impossible to study even casually all of the 90-odd Federal corporations. However, a brief survey will be made of a few of the more important, noting the functions which they perform and the extent to which they enjoy the advantages of the corporate form of organization. Those which will be considered are the Panama Railroad Corporation, the Inland Waterways Corporation, The Reconstruction Finance Corporation, the Federal Deposit Insurance Corporation, and the Tennessee Valley Authority.

1. *The Panama Railroad Corporation.* One of the first of the Federal government corporations was the Panama Railroad Corporation, which was established in 1904. The United States purchased the Panama Railroad at the time when it purchased

[3] See "Government Corporations: A Proposal" by Oliver P. Field, 48 *Harvard Law Review* 774, March, 1935.

the Panama Canal. The capitalization of the railroad was about $7,000,000.[4] This capitalization has remained the same, although there has been a suggestion recently that it should be scaled down to accord more nearly with the present earning capacity of the railroad.

Financially, the railroad has been a success. It has consistently earned a profit even during the depression. Of course, the railroad enjoys a monopoly and so long as this favorable situation continues it probably will be able to operate at a profit. In general, both passenger and freight rates are higher than corresponding rates on railroads in the United States. However, comparisons are not altogether valid because of the differences in operating expenses, construction costs, and persons who or organizations which are entitled to reduced rates and other privileges.

Although the operation of the railroad is the most important business venture of the Panama Railroad Corporation, the corporation operates a number of other businesses which are somewhat allied to its railroad activities. The Receiving and Forwarding Agency is one of the most important of these. This agency maintains excellent harbor and terminal facilities for handling commercial cargo. The Receiving and Forwarding Agency has consistently shown a profit. The Panama Railroad Corporation also operates ship-coaling stations which are located at both the Pacific and Atlantic entrances to the canal. In addition, the corporation owns and maintains a steamship line which operates between the canal and New York, San Francisco, and a few lesser ports. One outstanding authority who has made a study of the Panama Railroad Corporation makes this significant statement concerning the steamship line: "It is unquestionably one of the most efficiently conducted steamship services under the American flag."[5]

The railroad, the harbor and terminal facilities, and the steamship line are the only major business enterprises operated directly by the railroad company. However, the company owns a large number of other business enterprises such as hotels, real property,

[4] "Government-operated Enterprises in the Panama Canal Zone" by Marshall E. Dimock, p. 27.

[5] "Government-operated Enterprises in the Panama Canal Zone" by Marshall E. Dimock, p. 81.

and dairy farms, which are operated by employees of the Panama Canal.

In general, the Panama Railroad Corporation is quite independent in its relations with Congress. The secretary of war is its chief officer. Under him is a board of directors. The board of directors determines most of the policies of the corporation much as the board of directors of a private corporation determines policies for its organization. The more immediate executive control is divided between the Governor of the Panama Canal, who is president of the Panama Railroad Corporation and who is located in the Canal Zone, and the vice-president of the Panama Railroad Corporation, who is located in New York City.[6] The vice-president performs duties similar to those of a general manager of a private corporation. Although he is the chief executive officer, the immediate operations in the Canal Zone are not directly under his control but rather under the governor of the Canal Zone, who is the president of the Panama Railroad Corporation. In addition, there is a general manager of the railroad, but his control is not as extensive as his name might imply.

In the handling of its finances, the Panama Railroad Corporation resembles a private corporation. It is free from the hazards of annual appropriations by Congress. It is a self-supporting enterprise with considerable liberty to make use of its funds at the discretion of its board of directors. Its accounts are not subject to audit by the General Accounting Officer.

In speaking of its personnel and personnel system, Professor Marshall E. Dimock has this to say:

> Thirty years of construction and maintenance in the Canal Zone has produced a public service career, an institutional morale, and a personnel system which are distinctive and significant . . . No undertaking in the United States either public or private has probably been so free from dishonesty as has the Canal Zone development; nor is any group of people likely to be found which is more proud of its record or more jealous of its rights and privileges.[7]

[6] "Government-operated Enterprises in the Panama Canal Zone" by Marshall E. Dimock, p. 51.

[7] "Government-operated Enterprises in the Panama Canal Zone" by Marshall E. Dimock, p. 156.

The primary responsibility for the personnel system in the Canal Zone rests with the governor. The Panama Canal Act of 1912 confers upon the president the power to appoint and remove employees. In actual practice the governor, who represents the president and the secretary of war, has been given extensive control over the personnel system. Although the Panama Railroad Corporation is not under civil service regulations and a majority of its employees do not have civil service status, an increasing number of its employees are inclined to acquire civil service ratings. This is perhaps unfortunate. One of the advantages of the corporate form of organization is the freedom which it usually enjoys from the red tape and formalism of the civil service. The Panama Railroad Corporation has had this advantage in the past and it would seem better that it should retain this advantage in order that it may continue to operate efficiently as a business enterprise.

2. *The Inland Waterways Corporation.* One of the government-owned and -operated business enterprises which has been the storm center of much controversy is the Inland Waterways Corporation. This enterprise had its beginnings during the World War. Because of the need for additional transportation facilities at that time, the Federal government provided for water transportation on the Mississippi River, the Warrior River, and the New York Barge Canal under the director-general of the railroads. In 1920 and 1921 these transportation facilities on the Mississippi and Warrior Rivers were transferred to the secretary of war and the operations on the New York Barge Canal were discontinued.[8] In 1924 the Inland Waterways Corporation was established and the equipment turned over to this organization to operate. Congress stated that the corporation was created to carry on operations to the point where the system could be transferred to private operation to the best advantage of the government.

Under the law as it stands at present it is the declared policy of Congress to continue the transportation services until navigable channels have been completed which are adequate for dependable transportation, until terminal facilities are provided

[8] See "Government Owned Corporations" by Harold A. Van Dorn, Chap. IX; See also "Inland Transportation" by Sidney L. Miller, p. 679, footnote 2.

which are adequate for joint rail and water service, until joint rail and water tariffs are published and filed, and until private persons are ready and willing to engage in this water service.

The Inland Waterways Corporation has been viciously attacked by opponents of government ownership and operation. They charge that it competes unfairly with other forms of transportation. Although they admit that it has shown a profit during the past few years, they declare that in reality it has been heavily subsidized. They allege that its rights of way are furnished by nature and improved by the United States. It is true that the Federal government has spent millions of dollars in improving harbors, rivers, and canals and that these expenditures have not been charged to the Inland Waterways Corporation. The corporation, however, does pay maintenance charges on property which it owns and leases.

Opponents allege also that the Inland Waterways Corporation pays no interest on money invested in construction and equipment. Although undoubtedly true, this fact stands as a striking contrast to the top-heavy financial structures under which the railroads are staggering.

Opponents allege also that the Inland Waterways Corporation pays no taxes, carries no insurance, sets aside no sums for depreciation, is not responsible in suits for damages, and receives free office space. These are only partial truths. In general, the corporation pays little in taxes. It is also true that it does not carry marine insurance on its floating equipment because it finds it more economical to absorb the losses instead of paying the high premiums. It does carry insurance on its terminals and cargoes. The corporation does put aside sums for depreciation and is legally responsible to the full extent of damages. It is true that the corporation has free office space in the Munitions Building in Washington, but its other offices are rented and the payments for rental are included in its accounts.[9]

The Inland Waterways Corporation is organized as a corporation of the District of Columbia. The secretary of war is the incorporator. The capital stock of the corporation, all of which is subscribed for by the United States, is $15,000,000.[10] The corporation has the power to sue and be sued; to make contracts;

[9] Annual Report of the Inland Waterways Corporation, 1933, p. 16.
[10] U. S. Code, Title 49, Secs. 151–152.

to acquire, hold, and dispose of property; to incur obligations and to borrow money for temporary purposes; to appoint and fix the compensation of employees; to exercise the functions vested in the secretary of war in connection with its operations; and to exercise such other powers as may be necessary or incidental to fulfill the purpose of its creation.[11]

Although the Inland Waterways Corporation is a separate governmental entity, it is subject to the supervision of the secretary of war. The secretary of war is to govern and direct the corporation in the exercise of its functions. According to the statute, the secretary of war is to appoint an advisory board of six members who serve without compensation and who represent the commercial and business interests in adjacent territory. The function of the board, as its name implies, is to advise the secretary of war, to consider matters submitted to it by the secretary of war, and to make recommendations thereon. In addition to the six board members, the secretary of war is to appoint a person to act as chairman of the board, either an individual from civil life or an army officer detailed to act in this capacity. To this person the secretary of war may delegate any of the functions vested in him under the laws governing the Inland Waterways Corporation.[12]

The chairman of the board is the most important officer of the Inland Waterways Corporation. In him are combined the powers and duties of the president of a corporation and its general manager. For some time Major General Ashburn has served as chairman-manager. Authorities who have studied the administrative system of the Inland Waterways Corporation have suggested that in the interests of efficiency two positions should be created, a president of the board of directors and a general manager, and that the duties of the present chairman should be divided between them. The president would preside over the board of directors, represent the secretary of war in all matters pertaining to the Inland Waterways Corporation, and act as contact man with the other agencies in Washington and with the public. The manager could devote his time to the administration and operation of the business of the corpora-

[11] U. S. Code, Title 49, Sec. 155.

[12] U. S. Code, Title 49, Secs. 151 and 154.

tion.[13] In addition to the above-mentioned officers, the bylaws of the corporation have provided for a board of managers which is to have general direction of the business and to formulate the basic policies affecting the corporation.[14]

As has been previously pointed out, one of the supposed advantages of the government-owned corporation is its freedom from the rules and regulations of the Civil Service. Due to the financial independence of such corporations and the fact that many of them have boards of directors with considerable power, they can effectively resist the pressure for political appointments. Unfortunately, the Inland Waterways Corporation has not been free from political appointments. Under the law, the secretary of war governs the corporation, and he is free to appoint and remove employees. It is generally conceded that political appointments and removals have been common during the existence of the Inland Waterways Corporation and that the enterprise has suffered as a result.[15]

The law contains certain provisions with regard to the operations of the Inland Waterways Corporation. The corporation is to carry on the operations begun by the government during the World War, except those over the New York Barge Canal. These operations cover transportation on the Warrior and Mississippi Rivers. The law provides for the extension of service to any tributary or connecting waterway of the Mississippi, not including the Ohio, provided that the secretary of war after making a survey deems it to be in the public interest to extend such service. Likewise, the secretary of war may extend the services and operations of the Inland Waterways Corporation to the Savannah River under certain conditions. Before the Inland Waterways Corporation may extend its service it must obtain a certificate of convenience and necessity from the Interstate Commerce Commission.[16] Furthermore, the Interstate Commerce Commission has power to require joint routes and joint rates with connecting carriers. The secretary of war is author-

[13] See "Developing America's Waterways" by Marshall E. Dimock, p. 60.

[14] See "Developing America's Waterways" by Marshall E. Dimock, p. 113.

[15] See "Developing America's Waterways" by Marshall E. Dimock, p. 85.

[16] U. S. Code, Title 49, Sec. 153; Public Act No. 157, 75th Congress.

ized under circumstances stated in the statute to lease or to sell the transportation facilities of the Inland Waterways Corporation.

As has been previously stated, the Inland Waterways Corporation operates its barges on two important waterways, namely, the Mississippi and its tributaries and the Warrior River and connecting water routes. The Inland Waterways Corporation is divided into several sections, each of which operates over a portion of the waterways previously mentioned. The Upper Mississippi section operates from St. Louis to Minneapolis and St. Paul. The Lower Mississippi section operates from St. Louis to New Orleans. The Illinios section operates on the Illinois River from the Mississippi to Peoria and Chicago. The Warrior River section operates from New Orleans to Mobile and Birmingham. The Missouri River section operates from St. Louis to Kansas City.[17]

Obviously the Inland Waterways Corporation is able to interest only shippers for whom the time element is no factor. Water transportation is slow and cannot hope to compete with that offered by trucks or railroads in the shipment of most kinds of commodities. However, water transportation is inexpensive and therefore can make some appeal to certain classes of shippers. The Inland Waterways Corporation has shipped such commodities as rock, coal, hay, flour, steel, pig iron, cement, sulphur, cotton, sugar, grain, and other bulky commodities.[18] In 1933 all sections transported a total of 1,605,844 tons over the various routes. The equipment of the corporation consists of barges, towboats, tugs, and a few self-propelled barges. The corporation maintains a regular schedule of one, two, or three days a week depending on the section over which its ships and barges are operating.[19]

3. *The Reconstruction Finance Corporation.* One of the largest and best-known of the Federal government corporations is the Reconstruction Finance Corporation. Essentially, the Reconstruction Finance Corporation is a large government-owned and -operated banking enterprise. It was organized to lend money to business at a time when private institutions were unable to extend the credit which was necessary to maintain properly

[17] See Annual Report of the Inland Waterways Corporation, 1937, p. 29.
[18] See Annual Report of the Inland Waterways Corporation, 1933, p. 57.
[19] See Annual Report of the Inland Waterways Corporation, 1936, p. 31.

the needs of our capitalistic system. The corporation may lend money to banks, trust companies, credit unions, building and loan associations, insurance companies, and mortgage loan companies.[20] With the approval of the Interstate Commerce Commission it may lend money to railroads. It may lend money to industrial and commercial businesses if credit is not available at the banks. The corporation is empowered also to lend money to various other organizations mentioned in the act. In addition to its power to lend money, the Reconstruction Finance Corporation has been given the power to acquire stock in certain corporations. If a bank is in need of funds for capital purposes in connection with organization or reorganization or if an insurance company is in need of funds for capital purposes, the secretary of the treasury with the approval of the president can request the Reconstruction Finance Corporation to subscribe for preferred stock or to lend money secured by such stock.[21]

In its organization and powers, the Reconstruction Finance Corporation illustrates many of the things mentioned in the general discussion of government corporations. Congress has authorized capital stock of $500,000,000, which is subscribed to by the government of the United States. The management of the corporation is vested in a board of directors consisting of the secretary of the treasury and six other persons appointed by the president with the advice and consent of the Senate. The corporation may sue and be sued, make contracts, lease such real property as may be necessary for the transaction of its business, and make rules, regulations, and bylaws governing the manner in which its business may be conducted.

An important provision of the law is that which permits the corporation to select and to fix the compensation of such officers and employees as shall be necessary for the transaction of the business of the corporation, without regard to the provisions of other laws applicable to the employment of other employees of the United States.[22] As a result of this provision, the Reconstruction Finance Corporation is freed from the rules and regulations of the Civil Service as are many other government corporations.

[20] U. S. Code, Title 15, Sec. 605.
[21] U. S. Code, Title 15, Sec. 605e and Title 12, Sec. 51d.
[22] U. S. Code, Title 15, Sec. 604.

One of the most important powers of the Reconstruction Finance Corporation is its power to borrow money. Obviously a credit institution must have money which it can lend. The Reconstruction Finance Corporation would either have to depend upon appropriations from Congress, on money derived through the sale of its capital stock, or on funds which it might borrow. The Reconstruction Finance Corporation has been given extensive powers to borrow, thus giving it a degree of financial independence which is not enjoyed by all government corporations.

In one respect the Reconstruction Finance Corporation is more restricted than many government corporations. It does not have unlimited succession. According to the present law, it is to have succession for a period of 10 years from the date of the enactment of the statute under which it has been created, unless sooner dissolved by Congress. However, this temporary period of existence is a characteristic which the Reconstruction Finance Corporation shares with several other corporations which have been created by the Federal government since 1932 to perform what are presumably emergency services.

4. *The Federal Deposit Insurance Corporation.* Another of the recently created Federal corporations is the Federal Deposit Insurance Corporation. This corporation was established in 1933, after the "banking holiday," in order to protect depositors of closed banks. It is essentially a government-owned and -operated insurance enterprise. The corporation operates a fund which it uses to insure the deposits in all member banks. The corporation insures all accounts of $10,000 and less for 100 per cent, all accounts between $10,000 and $50,000 for 75 per cent, and all accounts which exceed $50,000 for 50 per cent.[23] If any member bank closes because of its inability to meet the demands of its depositors, the Federal Deposit Insurance Corporation acts as receiver. The corporation then organizes a new bank to assume the insured deposit liabilities of the closed bank, to receive new deposits, and to perform temporarily certain other banking functions. The corporation attempts either to sell the stock of the new bank or to dispose of its liabilities and assets to another bank. If this cannot be done within two years the bank is liquidated.[24]

[23] U. S. Code, Title 12, Sec. 264.
[24] U. S. Code, Title 12, Sec. 264.

In establishing the Federal Deposit Insurance Corporation, Congress has established an organization which has many of the characteristics of other government corporations. The management is vested in the comptroller of the currency and two other persons who are appointed by the president with the advice and consent of the Senate. Congress has appropriated $150,000,000, which is available for payment by the secretary of the treasury, for the capital stock of the corporation. In addition to this capital stock which is subscribed for by the United States, other stock divided into shares of $100 is held by banks. Class *A* stock is held by banks that are members of the Federal Reserve System and such other banks as may be entitled to become stockholders. Every bank which is a member of the Federal Reserve System must subscribe for class *A* stock equal to a certain percentage of its deposit liabilities. Class *B* stock, which is non-dividend stock, is held by the various Federal Reserve banks.[25]

The Federal Deposit Insurance Corporation is given the power to borrow money. According to law the corporation is authorized to issue debentures or other obligations in an amount aggregating not more than three times its capital.[26]

The general powers of the Federal Deposit Insurance Corporation are similar to the powers of other public corporations. It may make contracts, sue and be sued, and make bylaws. It may appoint employees, define their duties, and dismiss them at its pleasure. It is to have succession until dissolved by act of Congress.[27]

5. *The Tennessee Valley Authority.* Another large business enterprise owned and operated by the Federal government is the Tennessee Valley Authority, which was created in 1933 to maintain and operate properties owned by the United States at Muscle Shoals and to develop the resources of the Tennessee Valley. In establishing this business enterprise, Congress has again used the corporate form of organization. As a corporation the Tennessee Valley Authority enjoys many of the powers of an ordinary corporation. It may sue and be sued, make contracts, hold property, and exercise such powers as are necessary to carry out its purposes under the act. It also has the power

[25] U. S. Code, Title 12, Sec. 264c.
[26] U. S. Code, Title 12. Sec. 264o.
[27] U. S. Code, Title 12, Sec. 264j.

of eminent domain, a power which is very essential for carrying out its purposes.[28]

Although the average person thinks of the Tennessee Valley Authority primarily as a power project, its scope is far broader than the mere production of electricity. In its general aspects, it is a large-scale attempt to improve the standard of living for an entire section of the United States by conserving and utilizing the natural resources of that area. Many parts of its program could be performed by private business as efficiently as they are under government ownership and operation. However, private enterprise would be unwilling to develop the project as an entity because private capital would not be interested in the social aspects of the plan, but only in those parts which would yield a return on money invested. The various purposes that Congress has set forth to be accomplished by the Tennessee Valley Authority are all closely related, but private business probably would not or could not work out a coordinated program so as to achieve these purposes. The purposes of the Tennessee Valley Authority are to improve navigation, to prevent floods, to provide for the national defense, to produce electricity, and to conserve soil and prevent soil erosion.[29] All phases of the program are related and all are a part of the more important whole, namely, improving the condition of the entire area known as the Tennessee Valley.[30] Private capital, however, would be interested in only two of these, the production of electricity and the manufacture of commercial fertilizer.

Obviously navigation and flood control are closely related.[31] For more than 100 years the Federal government has been spending money to improve the navigable waters and to prevent the disastrous consequences of floods. In part, the Tennessee Valley project is an attempt to further these two purposes. The area covered by the project begins in northeastern Tennessee and follows the Tennessee River through central Tennessee, northern Alabama, and into western Tennessee to the point

[28] U. S. Code. Title 16 Sec. 831c.

[29] U. S. Code, Title 16, Sec. 831.

[30] For a discussion of the unified plan of development, see the bulletin, "The Unified Development of the Tennessee River System," published by the Tennessee Valley Authority, March, 1936.

[31] See Annual Report of the Tennessee Valley Authority, 1936, p. 5.

where the Tennessee River joins the Ohio River. In this area a series of dams, some of which have already been built, have been planned on the waterways of this section of the country. At Muscle Shoals in Alabama is the Wilson Dam built during the World War. Nearby is Wheeler Dam, which has been built by the Tennessee Valley Authority. Located above the head of navigation on the Clinch River in northeastern Tennessee is Norris Dam. At various other points in the valley other dams are proposed or are in the process of construction. There is much controversy over the navigation possibilities on the Tennessee River. Some persons contend that the government cannot hope to develop extensive navigation in this area. However, the Tennessee Valley Authority contends that studies of its Economics Division indicate that the probable volume of traffic will increase rapidly after the Tennessee River has been canalized and that ultimately the river may become one of the major waterways of the country.[32]

Whatever the ultimate benefits to navigation, the Tennessee Valley project should produce valuable results in controlling floods. The Tennessee River has had some disastrous floods in the past. Any material improvement would be a great boon to this area. The Tennessee Valley Authority contends that flood-control experience in the valley since the completion of the Norris and Wheeler dams has already demonstrated the great possibilities for control after the projects for the entire area have been completed.[33]

By cooperating with other agencies and the farmers in the area the Tennessee Valley Authority is attempting to prevent soil erosion and to prevent the sterilization of the land. Farmers have been encouraged and aided in terracing lands, in adopting crop rotation, and in employing other methods of preventing soil erosion. The Tennessee Valley Authority Act states that the corporation may manufacture and sell fertilizer and fertilizer ingredients.[34] The Tennessee Valley Authority has experimented with and investigated the relative merits of different fertilizers to discover those which will be most beneficial to the soil. Its research workers have discovered that by using phos-

[32] See Annual Report of the Tennessee Valley Authority, 1937, p. 5.

[33] See Annual Report of the Tennessee Valley Authority, 1937, p. 11.

[34] U. S. Code, Title 16, Sec. 831d.

phates the farmer can do much toward improving the quality of his lands. They have, therefore, worked out processes for producing phosphates which can be used to improve the quality of the soil on the farms in the Tennessee Valley.[35]

The use of the facilities of the Tennessee Valley Authority for purposes of national defense is of no importance in time of peace. In case of war the Tennessee Valley Authority could render valuable assistance to the military authorities. The plant at Muscle Shoals was built during the World War and was intended primarily for the production of nitrates to be used in the manufacture of munitions. The facilities of the Authority could again be readily used for munition purposes. The Tennessee Valley Authority Act provides that in case of war or national emergency declared by Congress any part of the property of the Authority shall be available to the government for the purpose of manufacturing explosives or for other war purposes.[36]

The best-known of the projects of the Tennessee Valley Authority is that of the production and transmission of electricity. The act states that the Tennessee Valley Authority may construct dams, reservoirs, power houses, and transmission lines. It may produce and distribute electric power. The corporation may sell its surplus power to states, counties, municipalities, corporations, and individuals. States, counties, municipalities, and cooperative organizations are to be given first consideration in disposing of the electricity which has been produced. If the corporation sells power to private corporations, it must require them to agree that the resale prices shall not exceed a schedule fixed as reasonable by the board of the Authority. A certain percentage of the gross proceeds received from the sale of power is to be turned over in taxes to the States of Alabama and Tennessee.[37]

The completion of the Norris and Wheeler dams has given the Tennessee Valley Authority considerable capacity for generating electricity. In order to dispose of its current, the authority had entered into contracts in 1937 with 32 local electric systems and nine large industrial corporations.[38] The Tennessee Valley

[35] See Annual Report of the Tennessee Valley Authority, 1937, p. 31.

[36] U. S. Code, Title 16, Sec. 831s.

[37] U. S. Code, Title 16, Secs. 831c, 831i–831l.

[38] See Annual Report of the Tennessee Valley Authority, 1937, p. 17.

Authority does not sell electricity to the ultimate consumer except in the case of industrial corporations. The individuals in the area are benefited through the sale of electricity to municipally owned systems or cooperative enterprises. About half of the distribution systems supplied with power by the Tennessee Valley Authority are municipal plants and about half are cooperative enterprises.

The average price of power sold to small municipalities and cooperatives during 1937 was 5½ mills per kilowatt-hour.[39] The theory on which the Tennessee Valley Authority has operated is that a considerable reduction in the price of electricity would result in a very large increase in consumption and that in the long run either a privately owned utility or a government enterprise would be financially benefited by the reduction. The Tennessee Valley Authority has fixed its rates and made contracts which it hopes will demonstrate the truth of this assumption. It has done all it can to stimulate in other ways the use of electricity, such as helping to finance companies which sell electrical equipment on the installment plan. This has not been done directly by the Tennessee Valley Authority but has been carried on through a corporation known as the Electric Farm and Home Authority.[40]

At the head of the Tennessee Valley Authority is a board of three directors. In some respects this board corresponds to the board of directors of a private corporation, but in other ways it is markedly different. For one thing, the directors are full-time paid officers who have many more actual administrative tasks than would ordinarily be conferred upon the directors of a private corporation. The act definitely confers upon them many powers and duties, and they have exercised a large number of these directly instead of delegating them to subordinates. Perhaps the fact that the board of directors has attempted to act as an administrative agent has been at the root of some of the difficulties of the Tennessee Valley Authority. A board or commission is, as a rule, an unsatisfactory administrative agent. Single, rather than plural, heads usually make for greater administrative efficiency and offer no opportunities for altercations or

[39] See Annual Report of the Tennessee Valley Authority, 1937, p. 20.

[40] See the bulletin of the Electric Home and Farm Authority, "Toward an Electrified America," published in 1934.

differences of opinion. Quasi-judicial and quasi-legislative tasks can be better performed by a board or commission, but the same cannot be said for the performance of administrative duties. Private corporations have discovered the value of single heads as administrative agents. Perhaps the Tennessee Valley Authority may be able to learn some valuable lessons from private corporations, which in many respects it so closely resembles. The Tennessee Valley Authority has a general manager and a large number of departments, such as a legal department, a personnel department, a finance department, a construction department, etc.[41]

One of the greatest drawbacks to government ownership and operation of business has been the prevalence of politics and the spoils system in public enterprises. Government businesses have often been greatly handicapped and placed at a serious disadvantage because they have been unable to adopt some of the more advanced personnel policies. If a government enterprise is free from politics and has developed a sound personnel system, one of the important objections to government ownership disappears. Fortunately, Congress has seen fit to take the Tennessee Valley Authority out of politics and give it an opportunity to develop its personnel system without political dictation. The act states that in the appointment of officials and in the selection and promotion of employees no political test or qualification shall be given consideration, but that all such appointments and promotions shall be made on the basis of merit and efficiency.[42] Thus, the Tennessee Valley Authority has been empowered to, and has, set up its own personnel system and adopted its own personnel policies. It is probably not an exaggeration to say that it has adopted some of the most enlightened and advanced personnel policies of any governmental agency. In fact, in some respects its personnel system compares favorably with some of the best in private industry. It has adopted detailed classification and salary schedules, using the Federal classification with modifications made to suit the needs of the Authority. The personnel department has followed the plan of many private corporations in recruiting new employees by sending out representatives to colleges, universities, and other

[41] See Annual Report of the Tennessee Valley Authority, 1937, p. 52.
[42] U. S. Code, Title 16, Sec. 831e.

places to interest and search for promising applicants to fill the numerous kinds of positions which it has to offer. The Authority has used various types of examinations to test the qualifications of prospective employees. In fact, the personnel department has even given tests for common laborers on one or two occasions.

The Authority has also adopted an elaborate system of promotion, transfer, demotion, and termination. An elaborate training program has been undertaken for employees.[43] One section of the personnel department has carried on research in order to discover new and better methods of personnel. This same section has also sought to create and foster good feeling between the employees and the management of the Authority. One of the most interesting features of the personnel program of the Tennessee Valley Authority is the Employee Relationship Policy. The official statement of the Authority's Employee Relationship Policy recognizes the right of employees to bargain collectively with the management. It has established machinery for the settlement of grievances. It sets up principles relating to wages, hours of work, safety and health of employees, and similar matters.[44] The Tennessee Valley Authority has sought to set standards by putting into practice in its own organization the most progressive personnel theories, thereby setting not only an example for other government agencies but also providing a yardstick by which to measure the personnel policies of private industry. The Tennessee Valley Authority seems to have made a sincere effort to establish a progressive personnel system. By doing this the Authority has taken an important step in the direction of assuring success for this gigantic geographical and social experiment and business venture which has been entrusted to it by Congress.

The Tennessee Valley Authority does not enjoy one of the important advantages of certain other government corporations. It is not a financially autonomous unit like the Panama Railroad Corporation or the Inland Waterways Corporation. It does not have capital stock but must rely upon Congress to appropriate

[43] For a discussion of the personnel system and policies of the Tennessee Valley Authority, see "Non-Civil Service Merit Systems of the Federal Government" by Wilma Langdon, Chap. IV, unpublished thesis submitted for the M. A. degree, copy available in the Indiana University Library.

[44] See "Employee Relationship Policy," par. 7.

money for its various projects. It may, however, spend the income derived from the sale of electric power. Although as yet this is not a great source of revenue, it probably will become such at some future time when dams and power projects have been completed.

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CHAPTER XXVI

STATE GOVERNMENT OWNERSHIP AND OPERATION

The ownership and operation of business enterprises by the various state governments has not been as common as the ownership and operation of business enterprises by either the Federal government or the municipal governments. From the beginning of its history, the Federal government has owned and operated its largest business, the postal system. Many municipalities have for a long period of time owned and operated water and electric utilities. However, there have been few types of businesses which have been extensively undertaken by the various states.

Throughout our political history, however, isolated illustrations can be found of state-owned and -operated enterprises. From time to time, various states have engaged in the business of banking. In most cases, these banking enterprises were undertaken during the latter part of the eighteenth century or at the beginning of the nineteenth century. For example, the Bank of New York was established in 1791, the Bank of Pennsylvania in 1793, the Bank of New Jersey in 1832, and a few others in other states about the same time.[1] Some of the states bought shares of stock in various railroads which they were interested in promoting. Before the adoption of the Eighteenth Amendment to the Constitution of the United States, South Carolina had established dispensaries for the wholesale and retail sale of intoxicating liquors and had forbidden the sale of liquors by private persons.[2] The State of Massachusetts for sometime has operated the Boston Elevated Railway Company through a board of trustees.[3]

[1] For a list of some of the states which established state banks and the dates when these were established see footnote to the case of Briscoe v. Bank of Kentucky (1837) 11 Peters 255(330), 9 L. Ed. 709(738).

[2] See Criminal Code of South Carolina, 1902, Chap. XXVII. This is referred to in South Carolina v. U. S. (1905) 199 U. S. 437, 50 L. Ed. 261, 26 S. Ct. 110.

[3] Special Acts of Massachusetts, 1918, Chap. 159. See also Helvering v. Powers (1934) 293 U. S. 214, 79 L. Ed. 291, 55 S. Ct. 171.

Many of the states have engaged in the manufacture of various commodities in prisons and other state institutions. Binder twine, shoes, brooms, and many other articles have been manufactured in these institutions. Obviously the primary purpose in such cases is not to engage in business but merely to occupy the time and utilize the labor of the inmates of these establishments. Sometimes the products which have been manufactured in such places have been sold in competition with goods which have been manufactured by private businesses. Because of objections from both capital and labor, states have often forbidden the sale of such goods within their own borders, thus forcing these public institutions to sell their products to persons in other states. Naturally other states have attempted to prevent the dumping within their borders of institution-made goods from other states. The Supreme Court of the United States held recently that a Federal law which made it unlawful to transport prison-made goods into a state that prohibited the importation of such goods did not violate the commerce clause of the Constitution.[4]

Because of objections raised by both capital and labor to the sale of institution-made goods in competition with the products of private industry, states have tended to confine manufacturing in their institutions to articles which can be sold to state, county, township, and municipal authorities. For example, the state institutions in Indiana manufacture scouring powder, soap chips, laundry soap, sweeping compound, brooms, brushes, mops, buckets, and similar things which are extensively used by governmental units for school and other public buildings. In order to induce local officials to use these products, the State of Indiana has organized the Sales Division of Indiana Industries, which maintains a staff of full-time salesmen, each of whom covers a regular territory.[5] Although there is probably less public objection to the sale of institutional products to governmental authorities than there is to the sale of these products to private persons, the economic effect is the same. If public institutions manufacture and sell their products to governmental

[4] Kentucky Whip and Collar Co. v. Ill. Cen. R. Co. (1937) 299 U. S. 334, 81 L. Ed. 270, 57 S. Ct. 277.

[5] See bulletin entitled "State Industry Products," published in 1936 by the Sales Division of Indiana Industries.

authorities, private businesses are thereby deprived of a portion of the market.

Probably the most extensive program of state ownership and operation was that undertaken by North Dakota after the World War. The Non-Partisan League, which gained control of the government of North Dakota, inaugurated in 1919 an elaborate system of state business enterprises. A state banking system known as the Bank of North Dakota was established, operated, and managed by the State Industrial Commission. Likewise, a system of warehouses, elevators, flour mills, and factories was established under the name of the North Dakota Mill and Elevator Association and was operated by the Industrial Commission. In addition, the Home Building Association was established to provide homes for residents of the state.[6] This elaborate plan of government ownership and operation was subsequently abandoned by the State of North Dakota.

During the last few years, however, there has been a trend in the direction of state ownership and operation of business enterprises. In at least four fields this trend is noticeable—liquor stores, public utilities, housing corporations, and state insurance.

I. Liquor Stores.

With the repeal of the Eighteenth Amendment the control of the liquor business was returned to the states. The problem of effective control had been difficult before 1918, and it was no easier after the experience with prohibition. Obviously the problem of control of this industry was not one of merely securing adequate service at reasonable rates, as was the case with many other businesses which the states sought to regulate or operate. The states were chiefly concerned with considerations of public health, morals, and safety. Many of the states merely provided for state regulation of the manufacture and sale of intoxicating beverages, but some of the states provided for state ownership and operation of various phases of the liquor business. Seventeen states have established state liquor stores. In three of these states—Alabama, Utah, and Idaho—liquor is sold only through state stores, but in the other states, liquor can be sold not only

[6] **Laws of North Dakota, 1919, Chaps. 147, 150, and 152.**

through state stores but also by persons under license.[7] Ohio is in this latter group of states. The Ohio system will serve as a good illustration of state ownership and operation of this type of business.

The legislature of Ohio has established the Department of Liquor Control, which is charged with the task of carrying out the provisions of the state liquor act. The department consists of a board of four members and a director. This department is authorized to put into operation, to manage, and to control a system of state liquor stores for the sale of liquor at retail.[8] Only one state liquor store may be established in each county, except in the more populous communities, where an additional store may be established for each 40,000 of population. In any locality in which the department deems it inadvisable to establish a state store, the department may appoint a person who is engaged in the mercantile business to act as agent for the sale of spirituous, that is, hard liquor and may fix his compensation in the form of an annual salary.[9]

In accordance with the statutory provisions the Department of Liquor Control has established a limited number of state stores and has authorized a few persons to act as agents for the sale of hard liquor in the various counties of the State of Ohio. In most communities only one store has been established. Even in a city as large as Toledo only 12 agencies and state stores are in operation.[10] Both wholesale and retail prices of hard liquor have been fixed by the Department of Liquor Control.[11]

As has been previously pointed out, the State of Ohio does not attempt to monopolize the entire liquor business. However, the Department of Liquor Control has almost a complete monopoly of the business of selling spirituous liquors at retail. The only exceptions are sales by the glass in hotels and restaurants and sales by the few retail merchants who, as has been previously mentioned, are authorized to act as agents and to sell hard liquor in communities which are not large enough to support

[7] See 10 *State Government* 194, September, 1937.

[8] Code of Ohio, Secs. 6064-2 and 6064-8.

[9] Code of Ohio, Sec. 6064-11.

[10] See the bulletin of the Department of Liquor Control of the State of Ohio entitled "Retail Price List No. 21," pp. 17–21.

[11] See bulletin of the Department of Liquor Control of the State of Ohio entitled "Wholesale Price List No. 21."

state liquor stores. In order to control other phases of the liquor business, the department is authorized to issue many kinds of permits to persons who wish to sell or manufacture intoxicating beverages. The department may issue permits to manufacturers of beer, wine, or spirituous liquors; permits to wholesalers of beer and wine; permits to hotels and restaurants to sell beer, wine, and hard liquor by the glass; and permits to owners or operators of retail stores to sell beer and wine in sealed containers.[12] A large number of permits have been issued to various persons in accordance with these statutory provisions.[13]

The Ohio Department of Liquor Control is a body corporate with many of the powers ordinarily conferred upon public corporations. It may sue and be sued, make leases, enter into contracts, and acquire and transfer title to personal property. The department is authorized to fix the wholesale and retail prices at which hard liquor may be sold through state liquor stores or agencies. Prices are to be fixed so as to produce not more than 30 per cent gross profit. The money derived from the sale of liquor in state stores is to be paid into the state treasury.[14]

The business of selling liquor seems to have been a profitable one for the State of Ohio. According to its balance sheet, the Department of Liquor Control had accumulated a surplus of more than $6,000,000 on Sept. 3, 1938 and had made a net profit for the four weeks ending Oct. 1, 1938 of $438,000.[15]

II. Public Utilities.

The earlier attempts at government ownership and operation of public utilities in the United States were made chiefly by municipalities. The many advantages of large public utility units, especially in the field of the production of electricity, have led to a demand, on the part of those who are interested in public ownership, for the operation of public utilities by larger units of government than municipalities. The Federal government has responded to this demand by establishing the Tennessee Valley

[12] Code of Ohio, Sec. 6064-15.

[13] See Regulations promulgated by the Board of Liquor Control of the State of Ohio, 1938.

[14] Code of Ohio, Sec. 6064-2.

[15] See "Balance Sheet as of October 1, 1938," issued by the Department of Liquor Control of the State of Ohio.

Authority. There has been some trend in the direction of state ownership and operation of public utilities. The creation of the Power Authority of the State of New York and the passage of the District Power Laws in some of the states, such as California, Washington, Nebraska, and Wisconsin, are illustrations of this trend.

In 1930 the State of New York created a commission to study the problem of the production of electricity from the water power on the Saint Lawrence River.[16] This commission recommended the creation of the Power Authority of the State of New York, which was to make arrangements and to provide for the establishment of the necessary facilities to engage in the production of electricity, which was to be sold to municipalities, private industry, and public utilities. The Power Authority of the State of New York came into existence in 1931 with authority to build and operate dams, power houses, and other facilities necessary for the development and sale of hydroelectric power.[17]

The Power Authority immediately undertook the necessary negotiations and laid out plans in accordance with the mandate of the legislature. The Authority, however, could make only preliminary arrangements until the ratification of a treaty between Canada and the United States concerning the use of the Saint Lawrence Waterway.[18] Although a treaty has been in the process of negotiation for a number of years, it has never been ratified. The Power Authority is still in existence and is continuing its surveys and studies of the problem of state production of electricity from power developed on the Saint Lawrence River.[19] Nevertheless, its plans cannot be put into operation until a treaty dealing with this important waterway is ratified between the United States and Canada.

A statute of the State of Washington furnishes a good illustration of the so-called district power laws which have been enacted by several of the states. This statute authorizes the formation

[16] Report of the St. Lawrence Power Development Commission, Jan. 15, 1931.

[17] Laws of New York, 1930, Chap. 207, Sec. 9; Laws of New York, 1931, Chap. 772, Sec. 5.

[18] See Second Annual Report of the Power Authority of the State of New York, 1931, p. 11.

[19] See Seventh Annual Report of the Power Authority of the State of New York, 1938.

of corporations, known as public utility districts, which may purchase, condemn, lease, construct, or operate water or electric utilities. Under the Washington law the districts may be areas of one *county* or *less.*[20] A similar act passed by the legislature of Wisconsin does not confine a power district to an area consisting of a county but allows any two or more municipalities, whether they are contiguous or not or in the same or different counties, to organize a municipal power district. The Wisconsin law also permits the annexation of any territory contiguous to a power district if a certain percentage of the qualified voters approve.[21] The State of Wisconsin is fostering the development of power districts by creating the Wisconsin Development Authority, which is authorized to promote and to encourage the organization or creation of these enterprises.[22]

Although the so-called power districts or public utility districts are not state-owned and -operated enterprises, they are definitely a step in that direction because they do pass beyond the boundaries of municipalities. In all probability there will be a tendency for these power units to combine and thus gradually develop into state-wide enterprises, or at least into systems which cover large areas of the state. In Nebraska this development is rapidly taking place. Nebraska has a public utility development under way which is sometimes referred to as a "little TVA." This consists of three large PWA-financed hydroelectric projects, the Platte Valley, the Loup River, and Tri-County, having a total cost of $50,000,000. These three enterprises propose to buy the private power companies in Nebraska and link them in a state-wide transmission system.[23] If these Nebraska projects should be successful in forming their "grid" system, as it is called, they will have developed the first publicly owned state-wide utility project in the United States.

III. Housing Authorities.

Another recent development in the field of state ownership and operation of business enterprises is the creation of Housing

[20] Laws of Washington, 1931, Chap. 1, Secs. 2, 3, and 6.

[21] Wisconsin Statutes, 1937, Secs. 198.02 and 198.19.

[22] Wisconsin Statutes, 1937, Sec. 199.03.

[23] For an account of these Nebraska projects see the article in the *Indianapolis Star*, Apr. 17, 1938, p. 11.

Authorities which are public corporations with power to build and rent housing facilities to tenants.

For several years there has been a serious shortage of houses and apartments in the United States. The depression has aggravated this situation. The shortage is especially acute in housing facilities for persons in the lower income groups. Private capital has been unwilling to build the kind of dwellings which a large part of the population can afford to rent because such buildings cannot be erected and rented at a profit. If dwellings for the lower income groups are to be built, government participation and probably government subsidies are essential.

The question is which of the various governmental units—Federal, state, or municipal—should undertake this kind of business enterprise. All three of these units of government have become interested in and have participated in housing programs in varying degrees in different localities. The Federal government has built and is operating a few housing projects without state or municipal participation. Some municipalities have established housing authorities. A few states, among them New Jersey, have established housing authorities which may receive Federal funds, encourage housing enterprises, and sometimes operate housing projects.

The State of New Jersey has established a public corporation known as the New Jersey Housing Authority and has authorized the Authority to conduct surveys, to engage in slum clearance, to select sites for projects, to sell property, to exchange property, and to construct, manage, and operate projects for families of low-income groups.[24]

In carrying out the legislative mandate in New Jersey, the Housing Authority has conducted several surveys and has engaged in considerable research. One of its most important studies is the "real property inventory" carried on in some of the larger cities of New Jersey.[25] The authority has also made a study of blighted areas in order to determine the relationship between such areas and the prevalence of crime, ill health, and juvenile delinquency. With the cooperation of the Federal government and through the aid of Federal funds, the New Jersey Housing

[24] Laws of New Jersey, 1933, Chap. 444, Secs. 7 and 8.

[25] See the bulletin of the New Jersey Housing Authority, "1934 Real Property Inventory for Newark, N. J."

Authority has completed and is operating several housing projects for persons in the lower income groups.[26]

IV. State Insurance.

Although the bulk of the insurance business in the United States is done by private companies, some of the states have established state insurance to protect persons against certain kinds of risks.

The most elaborate of the state insurance enterprises is the unemployment compensation insurance, under which persons who are unemployed are paid during a limited period of time a certain percentage of the wages which they received while working. Although it is sponsored by the Federal government and some of the administrative expenses are borne by the Federal government, unemployment insurance is administered and supported by each of the several states.

Although the majority of the states do not have state insurance for workman's compensation, several of them have established state insurance to cover employers who must compensate workers who are injured in the course of their employment. At present there are 18 states with state insurance for workmen's compensation. In some of these states, exclusive state funds have been established. In others, the state is in competition with stock or mutual insurance companies.[27] There has been much controversy over the relative merits of state and private insurance in the field of workmen's compensation. Where state funds are exclusive, the state should be able to offer this type of insurance at premium rates which are lower than those offered by private companies. A state insurance monopoly eliminates duplication of buildings, of office force, of salesmen, and of agents. Given honest and even reasonably efficient management, these advantages should result either in a lower premium rate to policyholders, a larger dividend to policyholders, or a higher scale of compensation to workers. There is some evidence that in states which have state insurance funds for workmen's compensation higher benefits are paid to injured workers and lower

[26] See the bulletin entitled "New Jersey Housing Authority."

[27] See "Workmen's Compensation Insurance in the United States as of July 1, 1938," *Bulletin* of the Bureau of Labor Statistics, Serial No. R. 815.

premium rates are charged to employers who must carry this kind of insurance.[28]

Although unemployment compensation and workmen's compensation are the principal illustrations of state insurance, a few of the states have other kinds of state insurance. Wisconsin has a life insurance fund which is in direct competition with private insurance companies. Only residents of the state are eligible. The state has no staff of agents to solicit business, although some circularizing of prospects is carried on through the mails.[29] In a few states, such as North Dakota, South Dakota, and Oklahoma, state hail insurance has been established. In North Dakota and South Dakota all "cropped" lands are automatically covered unless specifically exempted. Each year county assessors obtain from all farmers a sworn statement of their acreage and their crops under cultivation. From these reports county auditors insure all crops which have not been legally exempted.[30]

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[28] "The Workmen's Compensation Laws of Indiana" by John Paul Duncan, p. 289; unpublished thesis submitted for M. A. degree, copy available in Indiana University Library.

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CHAPTER XXVII

MUNICIPAL OWNERSHIP AND OPERATION

Municipal ownership and operation of business enterprises is much more common than state ownership and operation. The prevalence of municipally owned and operated businesses is due chiefly to the large number of municipally owned and operated public utilities of various types. Although instances are to be found of municipal ownership and operation of other businesses, they are greatly outnumbered by the large group of municipally owned and operated utilities, especially electric and water systems.

Municipal ownership and operation is one of the most controversial subjects before the people of the United States. In other countries municipal ownership is so common that the question is not even an issue.[1] In Germany for a long time municipalities have operated numerous kinds of public utilities, including water works, slaughterhouses, gas works, electric plants, street railways, and even organizations for the distribution of milk and other staples. In England, also, municipal ownership has been prevalent. Professor Hormell in writing of the situation there explains:

> The controversy over private versus public ownership of electricity no longer stirs the British public. The problem has been solved, temporarily at least, by a typically British compromise which recognizes that each type of ownership has a legitimate place in a national plan of electrical development.[2]

In this country, however, the controversy has been so bitter and tainted with so much propaganda that it is almost impossible to gather accurate information as to the success or failure of

[1] "Control of Public Utilities Abroad" by Oren C. Hormell.

[2] "Ownership and Regulation of Electric Utilities in Great Britain" by Oren C. Hormell, p. 1.

municipal ownership and operation. Those opposed to municipal ownership have placed every conceivable obstacle in the way of officials seeking to operate municipal utilities. Those in favor of public ownership have made all manner of extravagant claims, many of which cannot withstand the light of searching analysis. It is interesting to note that most of the controversy is over municipal ownership and operation of electric utilities. The public is so accustomed to government ownership and operation of water systems that this type of business enterprise gives rise to very little controversy. For example, it was reported in 1931 that all of the papers of Los Angeles supported the city water system and that all but two opposed extension of the municipal electric plant.[3]

If one attempts to look at the question without prejudice, one can see both advantages and disadvantages of municipal ownership of public utilities. Municipal ownership removes the incentive to pile up huge depreciation reserves, to pay large dividends to stockholders, or to enlarge the rate base by placing therein such intangibles as going value. This should result in lower rates to the public. In practice it is very difficult to ascertain whether or not rates are really lower in municipal utilities than in privately owned utility plants. Obviously it is unfair merely to compare the rates of a publicly owned electric plant with those of a privately owned plant. In order to be fair, many varying factors must be weighed and considered, such as sums paid for taxes, sources of supply (whether the generating plant is steam, hydroelectric, or diesel), size of the plant, the distribution system, the quality of service furnished, whether or not the municipal plant is regulated by a public service commission, and whether or not the municipal plant makes charges for furnishing service to other departments of the city government.

Another advantage of municipally owned utilities is lower executive salaries. Under private ownership these are very high, and this in turn may necessitate higher rates. However, by paying large salaries private plants may attract more competent officials for important posts. Although financial reward is by no means the sole stimulus to achievement, publicly operated business enterprises must pay higher salaries if they expect to

[3] See the article "Consider the Case of Los Angeles" by John Bauer, 20 *National Municipal Review* 729, December, 1931.

attract persons who can manage them as well and efficiently as private enterprises are managed. As a rule, wages are higher in public employment. Likewise, the government is more lenient in giving holidays and sick leaves to employees. One of the greatest advantages of municipal ownership and operation is that it eliminates the necessity for regulation. The apparently almost insurmountable difficulties of obtaining effective control of utilities have led people to believe that some kind of government ownership and operation is the only solution of the public utility problem.

On the other hand, one must admit that there are several objections to municipal ownership and operation. There is always the danger of the injection of politics into the operation of municipal plants. In other countries, such as Great Britain, Canada, Norway, and Sweden, this is not an important consideration. Although in this country in certain municipalities which have a good governmental tradition the danger of politics is not great, by and large we have had the spoils system in government and this stands as a constant threat to successful municipal ownership and operation of public utilities. Another objection to municipal ownership and operation is the possibility that it might stifle initiative and remove the incentive to progress. In the electric and telephone utilities especially, much progress has been made within a relatively short period of time. Most of this has been achieved through the initiative of persons in private plants. There is a serious question as to whether or not municipally owned and operated systems would do as much as private companies to further progress in these industries. Another objection to municipal ownership is the temptation which it offers to city officials to use the revenues from municipal utilities for purposes which have no connection with the furnishing of service. If the money which is taken from the utilities really represents excess earnings or surplus, there is little objection to its use for other municipal purposes, although many persons argue that such excess calls for a reduction in rates. Oftentimes sufficient sums are not left in the treasuries of municipal utilities to allow for depreciation or to permit new extensions when needed.

One of the greatest objections to municipal ownership, especially of electric utilities, is the stumbling block which it places

in the way of consolidation or unification. Private utilities have extensively merged, consolidated, or combined in other ways; whereas municipal plants have tended to remain as isolated units. Consolidation of electric utilities is highly advantageous if the benefits are passed on to the public. Such combinations offer better terms for financing, better engineering advice, and opportunities for the elimination of duplication. Furthermore, such unifications afford an opportunity for lowering the cost of generating electricity. This is especially true where hydroelectric generating plants have been substituted for steam plants.

Two factors, however, have been at work which offset to some extent the advantages that privately owned and operated electric utilities seem to offer in the way of consolidation. First, the substitution in small towns of so-called diesel engines in place of steam generating plants has greatly reduced the cost of generating electricity. Diesel engines are small oil-burning units which furnish the energy necessary to produce electricity. One finds many favorable reports upon such use of diesel engines.[4]

The second factor is the tendency of municipal plants to consolidate. Certain state legislatures have enacted laws to permit public operation on a scale larger than by single municipalities. For example, Nebraska, Washington, California, and Wisconsin have laws which permit the organization of power districts. By way of illustration, the Washington law authorizes the formation of corporations known as public utility districts which may purchase, condemn, lease, and construct water or electric utilities. These districts may comprise any area consisting of a county or less. The initiative in forming such districts may be taken by the board of county commissioners or 10 per cent of the qualified voters of the county. The question must be submitted to the

[4] "Municipal Diesel-Electric Plant in Coal Region Expands Out of Earnings" by O. L. Hebbler, 44 *American City* 131, February, 1931; "Municipal Diesel-Electric Plant Reduces Power Costs" by E. E. Buck, 35 *American City* 639, November, 1926; "Diesel Engine Causes Large Savings in Operation at Tallahassee Municipal Electric Plant" by B. H. Bridges, 41 *American City* 118, July, 1929; "Municipal Power Is Coming Back" by R. H. Bacon, 39 *American City* 141, November, 1928; "Meeting an Emergency with Diesel Engines" by Chas. Retallic, 40 *American City* 162, May, 1929; "Why Hudson, Massachusetts Approves Diesels" by L. D. Wood, 43 *American City* 87, August, 1930; "Strengthening the Position of Municipal Power" by R. E. McDonnell, 42 *American City* 125, March, 1930.

voters for approval. The powers of a public utility district are to be exercised through a commission of three members.[5]

The State of New York has attacked the problem of centralization in a different manner. New York has sought to establish a publicly owned and operated electric generating system on the Saint Lawrence River. With this end in view, the Power Authority of the State of New York has been created. The plan is to generate electricity through hydroelectric plants and to sell it to private and municipal utilities which in turn will sell it to consumers.[6]

The generation of electricity and its sale to municipal plants by the Tennessee Valley Authority is also conducive to the development of municipally owned electric distribution systems since they can purchase electricity at cheap rates and sell at rates comparable to those of any large privately owned utility with a hydroelectric power plant.

I. Extent of Municipal Ownership and Operation.

The average person probably does not realize the extent to which municipalities in the United States own and operate public utilities. Municipalities have had no occasion to advertise nor have they engaged in advertising the services which they perform; whereas privately owned utilities have for a long time engaged in an extensive advertising campaign. Of course the extent of municipal ownership varies considerably with the type of utility. Publicly owned and operated water plants greatly outnumber those which are privately owned. According to an estimate made in 1932 by McDonnell, Burns, and McDonnell Engineering Company, there were 7,736 municipal water plants and only 2,855 private water companies.[7] In fact, only two large cities, Indianapolis and Birmingham, are served by privately owned and operated water companies. Municipal ownership of water systems has aroused very little opposition, probably because the public is accustomed to public ownership of this type of business

[5] "Washington's Public Ownership District Power Law" by James K. Hall, 20 *National Municipal Review* 342, June, 1931.

[6] See annual reports of the Power Authority of the State of New York.

[7] See the bulletin on municipal water utilities published by McDonnell, Burns and McDonnell Engineering Company.

enterprise. In the case of water systems there is an additional argument for municipal ownership, namely, the necessity for control to protect the health of citizens. The city must regulate carefully the sanitary conditions of any company furnishing a water supply and sometimes the easiest way to control is to own and operate.

The Bureau of the Census reported that in 1932 there were 1,802 municipally owned and operated electric plants scattered throughout the United States.[8] Most of these are to be found in small or moderate-sized towns and cities, but at least three large cities—Cleveland, Los Angeles, and Seattle—have municipally owned and operated electric systems.

One of the best known of the municipally owned electric plants is that of Seattle. This system was started at the beginning of the twentieth century.[9] Its record is probably the equal of any large privately owned and operated utility plant. The municipal plant of Seattle has not had a monopoly but has competed with a private power company. The municipal plant has served about 80 per cent of the residential users and about 50 per cent of the industrial users of Seattle. The organization of the utility has been kept entirely separate from the other departments of the city. Its accounting and financial operations are distinct. It is financially self-sustaining, paying interest on its bonds and also a sum each year toward bond retirement. The rates compare favorably with those of privately owned utilities.[10]

Another of the successful electric plants is that operated by the city of Pasadena, California. It is estimated that this plant produces and delivers electricity at a total cost of 1 cent per kilowatt hour exclusive of interest and depreciation. The Pasadena electric utility is alleged to have made large profits, amounting to as much as $700,000 in one year. The plant has been so successful financially that it has loaned large sums of

[8] See news release, Bureau of the Census, Department of Commerce, 1933, First Series, L.P.-48.

[9] See Annual Report of the Department of Lighting of the City of Seattle, 1937, p. 12.

[10] See the articles, "Look at Seattle" by John Bauer, 21 *National Municipal Review* 40, 1932; "Control by City Competition" by Judson King, 47 *New Republic* 32, 1926; "Power and Politics in Seattle" by R. L. Hill, 134 *Nation* 253, March, 1932.

money to the city with which to construct such projects as an auditorium, a police station, and golf links.[11]

Cleveland began the electric utility business in 1906. The step was not premeditated but came about through the annexation of a village which had a publicly operated system. A second small plant was acquired in the same way in 1910. The Cleveland plant has been bitterly attacked by persons both inside and outside its organization who are opposed to municipal ownership. In spite of many difficulties, the plant seems to have been well maintained and to have offered continuous and reliable service.[12] One of the greatest achievements claimed for the Cleveland plant has been the reduction which it is alleged to have caused in the rates of private companies with which it has been in competition. In 1911 the rates of private companies were 11 cents per kilowatt hour. The Cleveland municipal plant inaugurated a 3-cent rate and gradually the rates of private companies were reduced.[13] There has been some dispute as to whether or not competition caused the reduction or merely improved methods and operations of the private companies.[14]

The largest city in the United States owning and operating its own electric plant is Los Angeles. During the first few years of its operation the Los Angeles plant did not have a monopoly but served in competition with two private companies. Recently the city acquired the last of its competitors in the electric utility field.[15] The rates are low and compare favorably with those in other cities.[16]

Municipal ownership and operation of street railways is not very common. Seattle, San Francisco, and Detroit are three

[11] "Pasadena Lights Its Own" by W. Sidney, 134 *Nation* 72, Jan. 1932; "Pasadena Gets Low-Cost Power" by James N. Hatch, 42 *American City* 116, April, 1930.

[12] See "Cleveland's Municipal Light Plant, Brief History and Present Status" by L. A. Quayle, a bulletin prepared in 1935 by the Department of Public Utilities of the City of Cleveland.

[13] "The Political Sabotage of the Cleveland Municipal Light Plant" by R. Husselman, 20 *National Municipal Review* 334, June, 1931.

[14] "The Economics and Politics of Cleveland's Plant" by H. Wright, 20 *National Municipal Review* 413, July, 1931.

[15] "Los Angeles Buys Local Gas Company's Electric System," 52 *American City* 71, April, 1937.

[16] "Consider the Case of Los Angeles" by John W. Bauer, 20 *National Municipal Review* 729, December, 1931.

large cities which own their own street railway systems. Likewise, utility systems for the production and distribution of gas are usually privately owned and operated. The City of Philadelphia owns its gas plant but leases it to a private company for operation. Omaha and Cleveland have publicly owned and operated gas systems. Recently the City of Indianapolis, after protracted litigation, acquired a gas system under a provision which had been placed in a franchise which had been granted to a gas company.

Municipal ownership and operation of telephone plants is rare. Several mutual systems are to be found in the United States. These are chiefly in rural areas and are not government-owned or -operated businesses but rather cooperative enterprises owned and operated by the subscribers themselves.

II. Legal Authority.

Municipal ownership and operation of public utilities gives rise to a number of legal questions, among which the more important are: (1) the sources of the power of municipalities to own and operate public utilities; (2) the methods of acquisition; and (3) state regulation of municipal utilities.

It is generally conceded that municipalities have no inherent power to own and operate public utilities. Sometimes a state constitution contains provisions pertaining to municipal ownership and operation, as in the case of the Ohio constitution, which states: "Any municipality may acquire, construct, own, lease, and operate within or without its corporate limits, any public utility the products or service of which is or is to be supplied to the municipality or its inhabitants, and may contract with others for any such product or service."[17] More often the authority to engage in the business of operating a public utility is derived from some statute enacted by the state legislature. The legislature, where it is not forbidden, may authorize a municipality to own and operate a public utility. Sometimes authority is expressly conferred upon a city to own and operate a water, gas, electric, telephone, or street railway system. Sometimes it must be implied from certain other powers which are given to a municipality. Thus, the power to establish a public water system might be implied from a grant of police power since

[17] Constitution of Ohio, Art. 18, Sec. 4.

a good water system is important to the health of a community and a protection against fire.[18] Likewise, the power to establish a plant for street-lighting purposes might be implied from a grant of police power because it would aid in curbing crime and would increase the safety of travelers.[19] On the other hand, it is difficult to find justification for the establishment of a street railway system under the police power of a city, because it would not aid in protecting the health, morals, or safety of the public. It is probable that the authority to own and operate a street railway would have to be expressly granted to a municipality and could not be implied from some other power.[20]

Unless a municipality has granted an exclusive franchise to a privately owned utility or in some other way limited itself by contract, it has authority to construct a competing utility system. Apparently it is immaterial that the privately owned utility is furnishing adequate service at reasonable rates.

Statutes or constitutions provide various methods by which municipalities may establish or acquire public utilities. One is the purchase of an existing private plant by negotiation with the owners. Another is acquisition of the system under the terms of a franchise granted by the city. For example, a municipality may grant a franchise to a company to own and operate a plant for the manufacture and distribution of gas within the city limits for a period of 25 years, provided that at the end of that period of time the company agrees to sell the gas plant at a sum fixed in the franchise. Despite the fact that such franchises often clearly state the right of the city to acquire the plant at the termination of the franchise and specifically set out the terms and methods of acquisition, utilities sometimes are successful in delaying transfer and in hindering the acquisition through resort to litigation.

Another method of acquisition is through condemnation. Acquisition of a utility system by condemnation necessitates a court proceeding. Obviously the privately owned utility will have many opportunities to delay and hinder acquisition by

[18] Ellinwood v. Reedsburgh (1895) 64 N. W. 885, 91 Wis. 131.

[19] "The Law of Municipal Corporations" by Eugene V. McQuillan, Vol. V, Chap. 35, 2d ed., p. 13.

[20] "The Law of Municipal Corporations" by Eugene V. McQuillan, Vol. V, Chap. 35, 2d ed., p. 13.

litigation. All too often this has been the case. Sometimes courts have added to the difficulties by giving a narrow construction to a statutory provision authorizing a municipality to acquire a public utility through the exercise of the power of eminent domain. The fourth method of acquiring a public utility is by acquiring land and erecting the plant. Frequently the question of whether or not a city shall undertake municipal ownership and operation by one of the methods suggested above must be submitted to the voters.

The question of state regulation of municipal utilities has given rise to much controversy. Some persons have contended that municipal systems should be subject to the same restrictions and regulations by the state as those which are imposed upon the privately owned utilities with which they are in competition. Other persons have argued that since they are operated by public officials for the welfare of the public and not for a profit, they should be completely immune from state regulation. The various state statutes indicate this diversity of opinion. In some states, such as Maine, the public service commission has been given extensive jurisdiction over municipal utilities. Certificates of convenience and necessity must be obtained before commencing operation. Rates and services are regulated. Reports must be made to the commission. The purchase and sale of utility plants must be approved by the public service commission.[21] In other states, such as Connecticut and Ohio, municipal utilities are exempt from the control of the public service commission.[22]

Another question closely related to that of state regulation of municipal utilities is that of state taxation of such enterprises. Some persons argue that it is unfair competition to grant municipal utilities immunity from state taxation and to require privately owned utilities to pay taxes. Other persons argue that such taxation is merely taking money from one public pocket and placing it into another. Although there is some logic in this latter argument, nevertheless, if municipal utilities are subject to state taxation, a better yardstick is established by which to measure their efficiency against that of privately owned

[21] Revised Statues of Maine, 1930, Chap. 62, Sec. 15.

[22] Code of Ohio, Sec. 614-2a; General Statutes of Connecticut, 1930, Sec. 3577.

enterprises. In some states, for example, Indiana, municipal plants must pay state and county taxes to the same extent as other utilities.[23]

III. Management of Municipal Utilities.

It is generally recognized that for efficiency of operation a municipal utility should be under the supervision of a general manager, who should have as much authority and control as that exercised by persons in similar positions who operate privately owned utilities. The important questions are, how is the manager to be selected, who is to control him, and what is to be the division of power between the manager and those who control him?

Probably the most successful arrangement is that which exists under a city manager form of government. In such cases the city manager himself is selected by a council for an indefinite period of time and on a nonpartisan basis. The city manager selects the manager of the municipal utility or utilities. When this type of government does not prevail, the question arises as to what arrangement will secure the greatest efficiency with the minimum of political interference. As a rule, a board or commission has the ultimate control, namely that of selecting the manager, fixing rates, and determining other matters of policy. The board is sometimes an independent board appointed by the mayor, selected by the council, or elected by the people.[24] Sometimes a standing committee of the city council selects the manager. Occasionally the manager is elected directly by the people, a method which is open to all the objections which can be raised against the selection of technicians and experts by the electorate.

Obviously a municipally owned and operated utility is going to have to adopt a number of rules and regulations which will vary with the nature of the utility. Fares or rates must be fixed. Rules must be laid down concerning the making of extensions into new territory. Regulations must be adopted with regard to schedules if the utility is a street railway system. Regulations concerning the pressure and purity of gas must be

[23] Laws of Indiana, 1933, Chap. 190, Sec. 16(d).

[24] "The Administration of Municipally Owned Utilities" by Delos F. Wilcox, p. 44.

made. Rules concerning the payment of bills must be fixed. Hours, wages, and working conditions for employees must be adopted. All of these and many others are matters of policy and as such should be adopted by the policy-making agent in charge of the municipal utility. If a board or commission is in charge, this group will probably act as the policy-determining agent. The task of carrying out these rules and regulations and the supervision of employees should rest entirely in the hands of the manager who is hired by the board.

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INDEX

F